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The economic situation in the Economic Commission for Europe region: Europe, North America and the Commonwealth of Independent States in 2010-2011

Summary

Of the five United Nations regions as defined by the regional commissions, the Economic Commission for Europe (ECE) region was the most negatively impacted by the recent financial and economic crisis. Real growth for the region declined from 3.2 per cent in 2007 to 0.9 per cent in 2008 to minus 3.7 per cent in 2009 and recovered to 2.6 per cent in 2010. However, 9 or about one sixth of the region's economies continued to experience negative growth in 2010. The current forecast is for growth of 2.8 per cent in 2011 and 2012. Owing to the crisis, sovereign debt levels have increased significantly in a number of the region's economies and have become problematic; this has led to premature fiscal consolidation that has delayed and weakened the recovery. In many economies (except in North America), gross domestic product (GDP) remains below pre-crisis levels.

Unemployment remains high in most of the advanced economies in the region and inflation is beginning to exceed central bank targets.

The ECE region has accounted for more than one half of world economic output (on a purchasing power parity basis) for over a century. However, its share of world GDP has recently fallen below 50 per cent owing to the more rapid growth in the developing economies. As recently as 2000, countries of the European Union and North America each accounted for more than a quarter of world output and the European emerging economies of East and South-East Europe, the Caucasus, and Central Asia accounted for another 5 per cent. The world share of the European Union and North America has now declined to just over one fifth each while that of the European emerging economies has increased to 6 per cent. The share of the ECE region in world output is expected to continue to decline in the coming decade as its growth in population and per capita income are both below world averages.

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I. The Economic Commission for Europe region in global perspective

1. The ECE region, composed of 56 member States, remains quite diverse. Although it contains most of the world's advanced economies, 26 (or almost one half) of its member States have a per capita income below twice the world average, while 12 of these are below the world average and 5 of these are below one half of the world average. Nine of its economies are considered as United Nations landlocked developing countries.

2. In the first two decades after the Second World War, the countries of Western Europe and the Soviet Union grew faster than the United States and there was therefore some convergence in the per capita incomes of these regions. By the early 1970s Western Europe had a per capita income of approximately 70 per cent of that of the United States, while the Soviet Union had a per capita income of about 35 per cent of the United States, or one half of Western Europe. However, since 1972 there has been no further convergence between Western Europe and the United States while the average income of the States of the former Soviet Union has declined to only one fourth of that of the United States and one third of that of Western Europe. Therefore, over the last 40 years there has been no convergence, but in fact some additional divergence, in the living standards of the three major geographical subregions of the ECE.

3. The ECE economies imported $9.7 trillion and exported $8.9 trillion in 2008; those economies account for 60.6 per cent of world imports and 56.0 per cent of world exports (using 2008 data as 2009 data is distorted by the significant trade declines associated with the global economic crisis). The world shares by major ECE geographical subregion are as follows: North America accounts for 16.1 per cent of imports and 11.1 per cent of exports, Europe (including South-East Europe, Turkey and Israel) accounts for 41.6 per cent of imports and 40.4 per cent of exports, and the Commonwealth of Independent States plus Georgia accounts for 2.9 per cent of imports and 4.5 per cent of exports.

4. Over the last three decades, growth in the advanced ECE economies has been relatively slow compared to other world regions and to their own post-World War II historical experience. In many of these economies, income and wealth inequality have increased; in particular, the income of the very rich has grown significantly above the average. Thus, the economic models of these economies have experienced difficulty in producing strong economic growth while maintaining or increasing the degree of equity. Nevertheless, in many of the Western European economies, especially those in Scandinavia, the levels of income and equity are among the highest in the world.

5. The general increase in income inequality in the ECE economies has been accompanied by a general increase in regional inequality within countries. The crisis appears to have further increased regional variations in income; for example in the United States between 2007 and 2009 income rose in several states but declined by over 10 per cent in two — Michigan and Nevada. Similar trends have developed in many of the ECE economies. In the European emerging economies significant regional variation exists in income levels as well as more general measures, such as in human development indexes; for example between the urban, especially the capital cities, and the rural provinces and in Ukraine between east and west. A

notable exception to this longer-run trend of greater regional inequality has been the convergence in incomes between the western and eastern regions of Germany and between northern and southern Italy.

6. An important consideration in evaluating national economic policy is the degree to which the country's national income is successfully used to promote the economic welfare of its population. Economic welfare remains a normative concept but the most important factor in determining its level is generally believed to be that of per capita national income. Additional considerations include a high degree of income, gender and ethnic equality, and high levels of education, leisure and health care (including life expectancy). Numerous attempts have been made to quantify economic welfare including that of the UNDP Human Development Index. Generally, these studies have concluded that the high-income advanced economies of the ECE region, especially the Scandinavian economies, have achieved the highest levels of economic welfare. After controlling for the level of per capita income, the European Union new member States and the European emerging economies are generally found to have high levels of economic welfare. However, somewhat paradoxically, surveys asking residents to rate their own happiness find that the European emerging economies do poorly after controlling for their level of per capita income.

7. The advanced ECE economies are the main global sources of outward foreign direct investment (FDI). The ECE economies accounted for almost $1.5 trillion in FDI outflows or over 76 per cent of the world's total FDI outflows in 2008. In 2009, total ECE FDI outflows declined by almost half to $780 billion. Of the world's top 20 sources of FDI, 15 are ECE economies. The United States is the largest source of FDI in the world, followed by France. In addition, the Russian Federation is a major source of outward FDI; in terms of both recent annual flows and in the level of FDI stocks, Russian outward FDI is similar in size to that of China. The ECE economies were the destination for almost $1.1 trillion of FDI inflows in 2008; this represented over 61 per cent of world FDI inflows. The United States is the largest recipient of FDI inflows in the world; Russia is the second largest emerging economy recipient after China. Overall, the UNECE region is a net investor (i.e., outflows exceed inflows) of FDI and in 2008 supplied approximately $400 billion of net FDI to the rest of the world. However, the European emerging economies are a net recipient of FDI (i.e., inflows exceed outflows) with their inward FDI stock almost twice the level of their outward stock.

II. The economic and financial crisis in the Economic Commission for Europe region

8. World GDP (on a purchasing power parity basis) declined by 0.8 per cent in 2009; the advanced economies (North America, Western Europe and Japan) were particularly negatively affected, although significant parts of the developing/emerging world (especially in Asia) largely avoided the worst of the crisis and were able to maintain reasonable although lowered economic growth. However, that was not the case for the European emerging economies and the new member States of the European Union, which were the most negatively impacted regions in the world.

9. Of the three subregions of the ECE (Western and Central Europe — including all of the European Union, North America and the European emerging economies),

the decline in GDP growth was the largest in the European emerging economies both in terms of its actual level in 2009, which was -6.2 per cent, and in terms of the decline relative to recent historical experience; the growth rate in 2009 was 13.8 percentage points less than the five-year average of 2003 to 2007. Western and Central Europe had a growth rate of -4.0 per cent in 2009, which represented a change of -6.6 percentage points from 2003-2007. North America was the least impacted ECE subregion with growth of -2.6 per cent in 2009, which represented a decline of 5.4 percentage points from the 2003-2007 average. Despite the fact that the emerging economies were the most severely affected subregion, eight of the economies had positive growth in 2009; Poland and Israel were the only remaining economies in the rest of the ECE to have positive growth in 2009.

10. Despite the severity of the financial shock, the aggressive use of monetary and fiscal policy, a relatively high level of economic cooperation among the Governments of the countries of the region, and assistance from international and regional financial institutions allowed the crisis to be contained. Without those unprecedented and quite extraordinary policy responses, in all likelihood, the region would have experienced another depression similar to the 1930s. The well-developed social safety nets of the region acted as automatic stabilizers and that further helped to maintain national income as well as limit the human and social costs of the crisis.

11. During the crisis, the United States implemented more aggressive monetary and fiscal expansions than the European countries; it lowered interest rates further and faster and its fiscal deficit was larger. There were numerous reasons for that but importantly, it was due to the fact that the social implications of high unemployment are greater in the United States than in Western Europe. The duration of unemployment insurance in the United States is shorter (often only 6 months although there were some extensions during the Great Recession) and since medical insurance is usually job-based, unemployed United States workers are vulnerable to losing their access to medical care. Given the higher social costs of unemployment in the United States, it puts greater emphasis on counter-cyclical macroeconomic policies.

12. Despite the ongoing recovery, this crisis will have significant long-term implications for living standards in much of the world and in the design and operation of domestic, regional and international institutions. Generally the crisis has reduced the influence of the ECE economies in global governance; for example, the G-20 has effectively replaced the G-7 as the main global body for promoting macroeconomic coordination and International Monetary Fund (IMF) board seats and quotas allocated to European countries have been slightly reduced. At the regional level, the crisis has resulted in significant institutional change within the European Union.

13. Although the new member States and the European emerging economies experienced a very serious crisis in 2009 with some large GDP declines, that crisis was not even close to the severity of the economic decline experienced in the 1990s during the transition from planned to market economies. All but a few of those economies will have higher real GDP by early 2012 than prior to the crisis in 2008 while many of them needed over 15 years to get back to their 1989 pre-liberalization levels during the transition crisis. However, the Russian Federation and many of the

Commonwealth of Independent States economies were more negatively impacted by the recent crisis than by the 1998 Russian currency crisis and sovereign default.

14. The severity of the crisis in the new member States and the European emerging economies was due to a number of significant vulnerabilities that had developed in many of them. They included extremely large current-account deficits, large amounts of short-term external debt (i.e., bank loans), rapid credit growth, which was especially problematic given that banks had quite limited credit histories for many of their borrowers, a high share of foreign-currency denominated loans, fixed exchange rates in some, and housing and asset bubbles. The one fundamental vulnerability often associated with a crisis which those economies did not have was either a large fiscal deficit or a high level of sovereign debt. In order to promote future financial stability, current economic policy should ensure that those vulnerabilities do not reappear as the recovery proceeds.

15. A number of ECE economies benefited enormously from external assistance provided by numerous multilateral organizations including the IMF, the European Bank for Reconstruction and Development (EBRD), and the European Union. As is generally the case, that assistance was contingent on the countries agreeing to implement certain policies or achieving certain targets. The IMF having received considerable criticism for the severity of its conditionality for the Asian economies during the 1998 crisis relaxed considerably its conditionality during the crisis. Nevertheless its policies generally required some tightening of the existing macroeconomic policy of the recipient country. Many of the programmes, especially those for the new member States were designed and financed jointly with the European Union. Generally it seems that the European Union pushed for stronger conditionality than the IMF in those joint programmes. During the crisis, 16 of the region's economies were forced to turn to the IMF for some form of assistance; that included several countries from each of the subregions, including 3 advanced economies, 4 of the new member States, 7 in the Commonwealth of Independent States and 2 in South-East Europe.

16. There was significant concern during the 2008/2009 crisis about the fact that the banking systems in many of the European Union new member States and South-East Europe had a high level of foreign ownership. There was the potential that the bank parents could have drained liquidity out of these economies to store up their parent operations. However, overall, that did not happen and it has now been concluded that foreign ownership generally proved to be a stabilizing influence. To some degree, that was due to the assistance those financial systems received from the IMF, EBRD, the World Bank, and the European Investment Bank under the Vienna Initiative. Nevertheless, foreign ownership does pose a possible systemic risk as has happened again in South-East Europe with the Greek debt crisis (as Greek banks have a market share of about 20 per cent in South-East Europe); thus, how to obtain the maximum benefit from international financial integration, while cross-border financial regulation remains limited, remains a challenge for policymakers.

17. Despite the severe economic downturn during this crisis, political and social stability were generally maintained throughout the region, although there were numerous demonstrations and some public disturbances in some of the most impacted economies. Therefore, the situation was considerably different from what developed in the 1930s. That was due importantly to the well-developed social

safety nets that have been created in those economies and the fact that Governments were able to contain the economic declines by aggressively using macroeconomic counter-cyclical policies.

18. Although there were a variety of underlying causes of the recent financial and economic crisis, a central factor was that the financial authorities in ECE advanced economies failed to properly regulate their financial industries. In the aftermath of the crisis, extensive regulatory changes have been implemented that should reduce the likelihood of a similar crisis in the future. However, in many cases the strongest or most extensive proposals were often times not implemented over concerns about how they might impact the competitiveness of a country's financial sector. A higher degree of regulatory harmonization achieved through better international cooperation could have reduced those concerns and produced a more stable financial sector.

19. The financial crisis highlighted several deficiencies in the institutional design of the European Union and in particular in the design of the eurozone. At the most general level, economic coordination among its members proved inadequate for crisis management. A centralized fiscal authority plays a central role in maintaining internal equilibrium in a currency union but that does not exist in the eurozone. Having a central bank that can act as lender of last resort can be a stabilizing influence during crisis periods; however, the European Central Bank is not authorized to carry out that function. The underlying logic in the design of the eurozone was that internal imbalances would primarily result from mismanaged public accounts but the crisis has demonstrated that the private sector can often create large imbalances even when government finances are prudent. In addition, the eurozone has no mechanism for correcting internal current-account imbalances other than deflation in deficit economies; this is a process that usually leads to long periods of high unemployment and can therefore be quite costly. Additional issues, such as how to achieve financial market integration while financial market regulation remained essentially national raised some fundamental issues about how the European Union was or should be designed.

III. The current economic situation

20. The moderate recovery of the ECE region in 2010 and 2011 is forecast to continue into 2012 and no widespread double-dip recession is expected. Nevertheless, many of the economies of the region will not return to their pre-crisis income level peaks (generally in 2008) until 2012. The economic recovery for the region will be moderate owing to the effects that unemployment will have on constraining consumer expenditures, the need for Governments to withdraw fiscal stimuli prematurely because of rapidly increasing debt levels, and owing to the fact that the financial systems in those economies remain partially impaired as they recapitalize and de-leverage. In several economies that experienced housing busts, the housing and construction sectors continue to act as a drag on the recovery. Growth for the European emerging economies is likely to be stronger than in the ECE advanced economies but they are bouncing back from steeper declines; the outlook for those economies is especially sensitive to global economic developments. Overall, that region will continue to experience growth rates in the coming years considerably below the world average as well as its own average in the five years prior to the crisis.

21. During the crisis, unemployment rose in most of the ECE economies throughout 2009 but stabilized in the early part of 2010; in the United States and the European Union the rate peaked at slightly over 10 per cent while it was close to, but slightly below, that in the largest emerging economies. However, unemployment exceeded 15 per cent in Estonia, Georgia, Latvia, Serbia, and Spain and 30 per cent in Bosnia and Herzegovina and the former Yugoslav Republic of Macedonia. The forecast is that unemployment rates in most of the ECE countries will remain significantly above trend for another three to four years. The human costs of those high levels of unemployment will further increase as unemployment insurance is exhausted and as households deplete their savings.

22. Given the declines in GDP that did occur, the declines in employment were greater than what would be expected in the United States and smaller than expected in Western Europe. Thus, although the decline in GDP was lower in the United States than in the eurozone, unemployment increased more in the former. That was due largely to the differences in labour market flexibility between the subregions. However, some European countries such as Germany, Italy and the Netherlands implemented a number of emergency or short-term labour market policies whose intent was to minimize job losses and a number of them proved to be quite successful. For instance, Germany experienced little change in unemployment as the rate in the spring of 2010 was similar to the rate two years earlier. The increase in unemployment in the Russian Federation was also quite small given the large decline in GDP.

23. In most countries of Europe and Central Asia the unemployment rates are two to three times higher for youths than for adults. That reflects the limited work experience of young job seekers and their greater vulnerability to economic downturns. Youth unemployment rates vary inversely with the level of education and particularly school leavers without work experience have low chances of finding jobs. The low level of educational attainment explains to some extent why unemployment of young job seekers from disadvantaged backgrounds is particularly high. Moreover, the fragile labour market position of youth reflects growing mismatches between their skills and those sought by employers. The recent crisis has further aggravated the situation of youth employment since employers have sharply cut recruitment of school leavers. The unemployment rate for minorities and certain ethnic groups are especially high; for example, in the United States the unemployment rate for black teens is 45.4 per cent. More generally, high youth unemployment presents a threat to social cohesion in a number of ECE mature and emerging economies.

24. Governments in Europe and Central Asia have responded to the economic crisis with various measures that seek to reduce unemployment. Such measures were aimed mainly at the preservation of existing jobs rather than the creation of new ones. However, some countries have also targeted the employment of young people with the aid of subsidized apprenticeship and internship programmes as well as wage subsidies or social tax reductions for new entrants. Nevertheless, very high levels of youth unemployment are likely to persist in a number of ECE countries for the next two to three years.

25. The recovery in the United States has been quite moderate owing to the drag from the housing sector. Sales of new homes early in 2011 were the lowest on record since statistics began in 1963 and significantly below the already depressed

levels in 2010. House prices have continued to decline and have now fallen more since their peak in 2006 than they fell during the Great Depression in the 1930s; inventories continue to rise as a result of foreclosures totalling about 600,000 a month. It is estimated that the wealth effects from the 30 per cent decline in United States house prices have depressed consumer expenditures on the order of $240 billion a year.

26. Core inflation in many of the ECE advanced economies and many of the new member States generally remains below central bank targets of about 2 per cent due to economic weakness. However, headline consumer prices in the eurozone and the United Kingdom have recently been increasing and for some time have been over their central bank targets. Concerns about the potential for further inflation have been accumulating owing to the rapid growth of central bank liquidity and rising global commodity prices. As a result the central banks in the eurozone and the United Kingdom are likely to gradually increase interest rates in the second half of 2011. The United States Federal Reserve is likely to withhold interest rate increases until there is more evidence that the core rate is increasing or that inflationary expectations are affecting wage demands. Inflation rates in the European emerging economies are generally in the higher single digits; those rates are more typical for those economies and represent to some degree their current and expected faster economic growth. In addition, the higher global commodity prices are likely to have a greater impact on inflation in the emerging economies since food prices represent a much higher percentage of their consumption expenditures.

27. Real trade (in volume terms) declined throughout the ECE region in 2009 compared to 2008 levels owing to the economic crisis. North American exports declined by 15 per cent while imports declined by 17 per cent; European exports and imports both declined by 15 per cent; Commonwealth of Independent States exports declined by 5 per cent while imports declined by 26 per cent. Although the real decline in Commonwealth of Independent States exports was relatively small, the nominal decline was quite large owing to the collapse in oil prices. Thus for example, Russian exports declined by 39 per cent in dollar terms in 2009. During 2010 trade rebounded but for many of the ECE economies had yet to get back to pre-crisis levels by the end of the third quarter of 2010; extra-European Union exports have grown much faster than intra-European Union exports owing to the economic weakness in that region.

28. The fiscal budget and debt situation of the advanced economies of the region has deteriorated considerably and in some cases has become problematic owing to the discretionary stimulus measures implemented but more importantly to the automatic stabilizers which resulted in declining tax revenues and increases in mandated income support measures. In some cases Governments felt obliged to assume the debts of their private financial sectors in order to stabilize their financial markets. Sovereign debt levels have become particularly worrisome, since the crisis-related debt has been added on to the already projected long-term fiscal deterioration due to demographic developments, unless there are significant changes in pension and tax policies. Significant market uncertainty exists as to whether the sovereign debt levels in some of the most severely impacted eurozone economies represent just a liquidity problem or a more serious solvency problem.

29. The sovereign deficit/debt situation of several eurozone periphery economies, including Greece, Ireland and Portugal and possibly Spain, Italy and Belgium has

become problematic. Interest rates on sovereign debt have become relatively high and have therefore raised concerns as to whether the affected countries will be able to fully service their debts. The European Union has responded by creating several facilities to aid economies facing financing difficulties. A support package of €110 billion was designed and provided to Greece. A more general facility available to any eurozone economy was established (worth about €750 billion) which provided assistance to Ireland and Portugal in the first half of 2011. This temporary facility will be made permanent in 2013 and named the European Stability Mechanism (ESM). All this assistance has been designed and implemented with the assistance and funding of the IMF. Countries receiving funds are subject to conditionality regarding macroeconomic variables and more generally, the eurozone has implemented more stringent ongoing macroeconomic requirements in order to maintain each country's competitiveness within the eurozone.

30. Global imbalances are considered to be one of the root causes of the economic crisis. The United States current-account deficit exceeded 6 per cent of GDP during 2006 but declined to 3 per cent of GDP at the end of 2009 and remained at only 3.4 per cent of GDP in mid-2011. The uneven recovery whereby the developing economies, including especially China, grew much faster during 2009-2011 than the United States had the desirable effect of keeping global imbalances from returning to their levels prior to the crisis. However, once a global recovery is fully achieved, it is likely that imbalances, and the vulnerabilities they create, will return to undesirable and unsustainable levels if not properly addressed with exchange rate adjustments. Imbalances are also a major problem within the eurozone and the inability to adjust exchange rates are making a resolution of that problem particularly difficult.

31. A significant vulnerability for many of the non-resource-rich European emerging economies prior to the crisis were large current-account deficits due to the dependence of these economies on foreign savings to finance their development. The current-account deficits narrowed quite significantly and rapidly once the crisis hit. The average current-account deficit for the new member States declined from approximately 12 per cent of GDP in 2007 to roughly nil in 2009. The adjustment in the current-account deficits of the Baltic economies has been exceptionally large. The current-account deficits in the new member States and South-East Europe are forecast to remain reasonably low and would therefore appear to be sustainable. That is due to the expectation that capital inflows to those regions will be considerably smaller in the future than they were before the crisis. As a result, it will require a structural change in their underlying growth models from an emphasis on externally financed consumption and investment to domestically financed export production. However, by mid-2011 several European emerging economies, including Turkey and Belarus, had developed large current-account deficits which were becoming problematic. The resource-rich Commonwealth of Independent States economies had large current-account surpluses prior to the crisis; they averaged 15 per cent of GDP in 2008. During the crisis those surpluses declined to only 3 per cent of GDP in 2009. As world growth has picked up, the surpluses have begun to increase again and the IMF forecasts that by 2013 they may average about 10 per cent of GDP, which was their level in 2006.

32. For a number of the European emerging economies, remittances are a very significant component of gross national income (GNI). In 2009 remittances were officially reported greater than 10 per cent of GDP for Albania (10.9 per cent of

GDP), Bosnia and Herzegovina (12.7 per cent), Moldova (23.1 per cent) and Tajikistan (35.1 per cent); other estimates for years prior to the crisis have generally found that remittances were above 10 per cent of GDP in a number of other ECE economies, including Armenia, Georgia, Kyrgyzstan and Uzbekistan. For some of those economies, remittances represent a larger financial inflow than either private capital flows or foreign assistance. In the Commonwealth of Independent States, 31 million people have emigrated to work in another country. Remittances, especially from the Russian Federation, fell by over 30 per cent (or 39 per cent from trend) during the peak of the crisis and were a major channel by which the crisis spread to some of the other Commonwealth of Independent States countries. In 2009 remittances shrank by 36 per cent in Moldova, 28 per cent in Kyrgyzstan and 31 per cent in Tajikistan. Remittances modestly rebounded in 2010 but remained well below 2008 levels. Remittances are far less important, but still significant for many of the new member States.

IV. Progress in achieving the Millennium Development Goals

33. Although significant progress has been made towards achieving the Millennium Development Goals at the global level, the economic crisis has set back progress in some countries for some of the targets. As a result the developing countries remain especially dependent on official development assistance (ODA) from the advanced economies to get back on track. The ECE economies account for 89.4 per cent of total Development Assistance Committee (DAC) net ODA and it is therefore their ability to maintain or increase assistance over the next several years that will be critical. The ODA to gross national income (ODA/GNI) target for 2010 of .34 committed to at the Gleneagles G8 meeting and at the United Nations Millennium +5 Summit was not achieved for a number of reasons, including most likely the economic crisis. Particularly important in the failure to achieve the target was the failure by the European Union to achieve its ODA target of .59 of GNI; it provided only .48. Despite missing its ambitious target, however, the European Union still provides a higher percentage of its GNI than the non-European Union members (except Norway).

34. Within the ECE region, progress in achieving the Millennium Development Goals in the European emerging economies and the new member States has been mixed. Given the large economic declines associated with the transition from planned to market economies, there were significant declines in many of the Millennium Development Goal indicators during the 1990s. Although more recent progress had been strong, even prior to the crisis in early 2008 not all the European emerging economies were on track to achieve all the Millennium Development Goal targets by 2015. With the severe downturn resulting from the 2007-2010 economic crisis, progress has been derailed. Achievement of the Millennium Development Goals is most problematic in the Commonwealth of Independent States, and most likely in the new member States with South-East Europe in between. Overall, progress has been weakest for the health and environmental indicators.

35. Many of the Millennium Development Goal targets have not been achieved in the ECE economies owing primarily to the fact that the targets have not been achieved for specific disadvantaged groups including certain ethnic communities and geographical subregions. Thus, progress in achieving those objectives could benefit especially from more-focused targeting of the specific vulnerable groups. That is

especially true for the Roma in some of the new member States and South-East European economies, whose relative plight in terms of employment and education outcomes have deteriorated since the transition to market economies. Integration of this group requires increased public support for housing, education and health and better implementation of anti-discrimination employment policies. Increasing their employment in the formal sector would increase tax revenues and social security contributions and as a result increased assistance could be largely self-financing.

36. Across the ECE region, women tend to have lower economic activity rates than men, are concentrated in fewer occupations, work fewer hours in paid employment (because of the higher prevalence of part-time working) and have more career interruptions, owing largely to care responsibilities. The adult employment-to-population ratio (aged 25 and above) in 2008 in the ECE was 51 per cent for women and 69 per cent for men. Half of all working women in the European Union are concentrated in either education and health (34 per cent) or the wholesale and trade industry (17 per cent) while half of all working men are concentrated in manufacturing (22 per cent), wholesale and retail (14 per cent) and construction (13 per cent). That gender segregation of women and men in the labour market reflects gender stereotypes in education and the prevailing gender roles in society. Educational choices are strongly gender-biased: women represent the large majority (three quarters) of tertiary students in health- and welfare-related subjects but are a minority (one quarter) in engineering, manufacturing and construction. The gender differences not only result in lower national economic output but also raise equity issues as they contribute to lower earnings (gender pay gap) and slower career progressions, which accumulate over a lifetime to lower pensions in old age. One area for which gender parity has been largely achieved in the ECE region is women's completion of schooling; in fact, women have started to outnumber men in tertiary education.

V. Economic integration and competitiveness in the Economic Commission for Europe region

37. Creating more dynamic and competitive economies through technological advancement is a key factor for increasing living standards in the countries of the ECE. Achieving this objective will require improving the educational levels of the population. Education has a significant public goods component and thus requires significant public funding. Public policies to support research and development is also required owing to its public goods nature or the externalities involved; taxes and subsidies may be needed to increase private sector research and development. Given the extensive changes in industrial structure that will be required to deal with climate change in the coming decades, policies to enhance innovation need to be framed within a technological framework that recognizes those climate- and energy-related considerations. The European Union Europe 2020 Strategy for Jobs and Growth appears to address those issues and provides a framework for other economies to consider; however, implementation will be key since the objectives in its previous Lisbon Strategy were largely not achieved.

38. The ECE economies have extensively pursued economic integration both globally and regionally; as a result, their trade-to-GDP ratios have been increasing consistently over the previous two decades. Although this has produced significant

growth in GDP, it has also resulted in the loss of national autonomy in a number of economic areas to the more general forces of "globalization". Global integration has occurred primarily under the trade liberalization rounds under the auspices of the World Trade Organization (WTO); completion of the currently stalled Doha negotiations remains a key stated objective of most of the ECE economies. However, periods of economic stress with high levels of unemployment are not considered conducive for further trade liberalization.

39. Currently, WTO has 153 members, which account for 97 per cent of world trade. However, seven of the Commonwealth of Independent States economies (Azerbaijan, Belarus, Kazakhstan, the Russian Federation, Tajikistan, Turkmenistan, and Uzbekistan) and three of those in South-East Europe (Bosnia and Herzegovina, Montenegro, and Serbia) have yet to gain accession to WTO. That has been a significant factor that has limited the integration of those former transition economies into the world economy. The Russian Federation is the largest ECE emerging economy and the only G-20 country not in WTO. The Russian Federation has concluded agreements that address most of the substantive economic issues for membership and if some remaining largely political issues can be resolved, its accession would appear to be imminent.

40. Within the ECE, regional integration has occurred significantly owing to the creation of preferential trade agreements; all the ECE economies are partners in at least one preferential trade agreement. These include: in Western Europe, the European Union and the European Free Trade Area; in North America, the North America Free Trade Agreement (NAFTA); in South-East Europe, the Central European Free Trade Agreement; and in the Commonwealth of Independent States there are several institutional frameworks; the Eurasian Economic Community and the Economic Cooperation Organization. Within the European emerging economies almost one half of trade is between preferential trade agreement partners (compared to a world average of one third) but in some cases these agreements are poorly implemented. In some cases there is some preferential arrangement between the different regional trade blocs, such as between the European Union and CEFTA, but generally economies in different preferential areas are integrated primarily on a multilateral non-discriminatory basis under the WTO. For example, there is no preferential arrangement between the United States and the European Union.

41. The economies in ECE trade extensively with the other ECE economies. Over 78 per cent or almost four fifths of exports from ECE economies go to another ECE country. This percentage was stable between 2002 and 2008, although it declined slightly to 76 per cent in 2009 owing to the unusual trade developments associated with the financial crisis. During 2008, 82 per cent of the exports of the 17 members of the European Union (the pre-2004 15 members plus Malta and Cyprus) went to another ECE economy; the percentage of exports to the ECE economies for the other subregions were: 94 per cent for the 10 new member States of the European Union, 57 per cent for North America, 94 per cent for South-East Europe, 84 per cent for the Commonwealth of Independent States, and 79 per cent for the remaining ECE economies.

42. As a result of this pattern of preferential trade agreements and the importance of geographical distance in determining trade, trade within the ECE subregions dominates trade between subregions. For example in 2009, 72 per cent of European exports went to other European partners, and 48 per cent of NAFTA (North American

plus Mexico) exports stayed in NAFTA; the Commonwealth of Independent States is somewhat of an exception as only 19 per cent of its exports stay in the Commonwealth of Independent States. Only 7 per cent of European exports go to North America while 18 per cent of North American exports go to Europe. Nevertheless, the European Union and the United States are each other's largest export market. Trade between North America and the Commonwealth of Independent States is quite limited; only 5 per cent of Commonwealth of Independent States exports go to North America while less than 1 per cent of North American exports go to the Commonwealth of Independent States. With United States-Russian bilateral trade, neither economy is a top 10 destination for the other's exports. Only 3 per cent of Europe's exports go to the Commonwealth of Independent States although 53 per cent of Commonwealth of Independent States exports are destined for Europe; the European Union is the largest import source and export destination of the Russian Federation. Also intraregional trade within the Commonwealth of Independent States has been declining in importance; for example, Russian imports from the other countries of the Commonwealth of Independent States has declined from 25.6 per cent of its imports in 2000 to only 13.7 per cent in 2008.

43. Unilateral preference programmes established by the advanced economies for the developing/transition economies are termed a Generalized System of Preference (GSP). Within ECE, the United States, the European Union, Canada, Norway, Switzerland, the Russian Federation and Turkey have such programmes. Except for the Russian Federation and Norwegian programmes, most of the European emerging economies are GSP beneficiaries (or are eligible for even better programmes as with the European Union and its Stabilization and Association Agreements with South-East Europe or its Autonomous Trade Preferences with Moldova). Preferences are provided for only a limited set of goods, generally only one third to one half of products are covered. Although these programmes do not require reciprocity (i.e., tariff concessions by the developing/transition countries), they often do have some criteria that must be satisfied. For example, currently Belarus, Tajikistan and Turkmenistan are not eligible for the United States GSP owing to concerns about intellectual property or labour standards. The European Union withdrew GSP eligibility for Belarus over labour standards.

44. The eurozone increased to 17 members by adding Estonia on 1 January 2011, making it the fifth new member State to join. The remaining seven new member States are obliged to join sooner or later; although currently none of the remaining new member States meet the entry requirements. Some of them have pegged their currencies to the euro for a number of years and would likely benefit from accession as it would likely further reduce interest rates and increase foreign direct investment levels. The new member States with flexible exchange rates (Czech Republic, Hungary, Poland and Romania) benefited from their ability to depreciate as a useful substitute for wage flexibility during the global economic downturn. Longer term, those countries are likely to join the Economic and Monetary Union only after they achieve higher productivity levels and nominal price convergence. The United Kingdom, which is also outside the eurozone, also benefited considerably from its ability to depreciate its currency versus the euro.

45. There are currently five European Union candidate countries, one of which (Iceland) decided to apply for membership in the wake of a massive financial destabilization hitting its relatively small economy in 2008-2009. The remaining candidate countries (Croatia, Montenegro, the former Yugoslav Republic of

Macedonia and Turkey) started their accession process earlier. The remaining South-East European countries (Albania, Bosnia and Herzegovina, and Serbia) continue to pursue European Union membership; currently Albania has a Stabilization and Association Agreement (which generally includes duty-free and quota-free trade for most industrial and agricultural products) whereas Bosnia and Herzegovina and Serbia have more limited Interim Trade Agreements while they wait for the Stabilization and Association Agreement process to be completed.

46. CEFTA has eliminated or reduced significantly tariffs on the goods of the participating countries but does not abolish customs controls at common borders; it has largely eliminated a complex web of bilateral agreements that were confusing and difficult to implement. The Agreement has been signed by Albania, Bosnia and Herzegovina, Croatia, Moldova, Montenegro, Serbia, the former Yugoslav Republic of Macedonia and the United Nations Interim Administration Mission in Kosovo. CEFTA aims to expand trade in goods and services, foster FDI, protect intellectual property rights in accordance with international standards and harmonize competition rules and state aid. It also includes well-developed procedures for dispute settlement. The Agreement conforms to the rules and procedures of WTO and European Union regulations and provides a framework for the contracting Parties to prepare for European Union accession (the founding CEFTA members are now all members of the European Union).

47. Following a number of unsuccessful attempts to establish a customs union on the territory of the Commonwealth of Independent States, three Commonwealth of Independent States countries (Belarus, Kazakhstan and the Russian Federation) finally implemented one by establishing a common customs code in July 2010 and have further committed to remove all customs borders within their territories in July 2011. A key challenge will be to ensure that the Customs Union Commission of the three countries becomes an effective dispute settlement mechanism. In addition to the customs union, the Governments of Belarus, Kazakhstan and the Russian Federation have declared their intent to deepen mutual economic integration by establishing the common economic space in 2012. Those countries have also agreed in principle to harmonize a number of technical, sanitary and phytosanitary standards which will be similar to those of the European Union as the Russian Federation has already harmonized those standards with the European Union.

48. Several of the Commonwealth of Independent States economies have production and export structures excessively concentrated in energy-related products. For example in 2009, fuel products (SITC 3) accounted for 93 per cent of the exports of Azerbaijan, 70 per cent of the exports of Kazakhstan, and 67 per cent of the exports of the Russian Federation. Although production and export of those products have produced substantial revenue for governmental developmental objectives, including infrastructure development, those commodity sectors do not generally produce large numbers of well-paying jobs and have limited beneficial linkages to other sectors. It is a policy objective of most of the economies to diversify into high value-added manufacturing and services although progress to date has been limited.

49. Future growth in many of the ECE economies needs to be more export-led; as a result policy initiatives are needed that can facilitate that adjustment. They include further trade liberalization (along with WTO accession for non-members), improvements in infrastructure, education and skill levels, promotion of domestic innovation, streamlining border-crossing procedures, the computerization,

simplification and harmonization of customs documents and procedures, and improvements in the investment climate. In the European emerging economies, foreign investment that can bring in managerial and technological expertise can be increased by strengthening intellectual property rights. In some of the ECE economies which had large current-account deficits, unit labour costs rose too fast during the boom period prior to the crisis and adjustments are now needed; that can occur through currency depreciation where possible, deflation or increased productivity growth.

50. Economic integration among the countries of the Special Programme for the Economies of Central Asia (SPECA) remains limited owing to a number of institutional and economic factors. Although there are a number of broad regional initiatives, including those administered by the Commonwealth of Independent States, the Eurasian Economic Community, and the Economic Cooperation Organization, trade agreements in the region are generally bilateral, differentiated, and overlapping. That has created a "spaghetti bowl" effect where the entangled trade policy rules are often very complicated, conflicting and confusing, which makes them hard to implement. The regional agreements attempt to link together a varied trade landscape with different levels of liberalization, which varies from the very liberal in Kyrgyzstan to fairly liberal in Azerbaijan, Kazakhstan, and Tajikistan, to quite restrictive in Uzbekistan. Trading opportunities are further limited by inadequate trade finance capacities. In addition, the physical infrastructure developed prior to 1990 was centralized in a hub-and-spoke structure, with most of the SPECA countries being spokes with connections to the hub but not among one another. Projects are gradually being put in place to create connections between these former "spokes" but there is still much work to be done and the lack of adequate physical infrastructure is an additional barrier to intraregional trade.

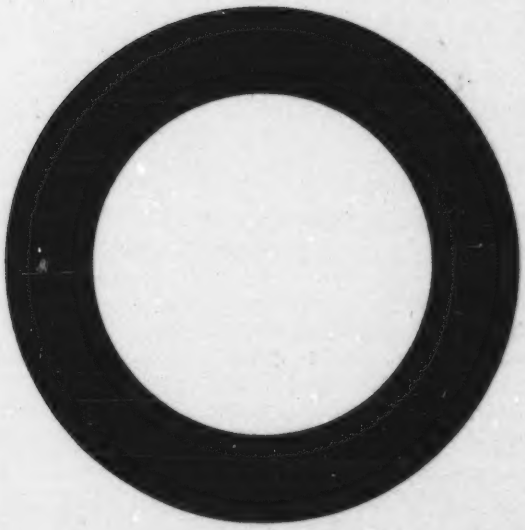
51. As a result of the above factors, intraregional trade remains limited, representing less than 10 per cent of the total trade of the countries of SPECA. Moreover, state-owned companies continue to generate the bulk of this trade, often under intergovernmental agreements that involve a select range of capital goods and energy resources. That has rendered a situation whereby products that rank high on SPECA countries' exports to the rest of the world are largely excluded from intraregional trade flows. At the same time, exports remain geographically concentrated in a narrow range of countries, namely China, Italy, France, Germany, the Russian Federation, and the United States, which together account for 62 per cent of SPECA countries' total exports of goods.

52. To reverse those trends, the SPECA countries adopted in 2010 a common framework for fostering intraregional trade. The framework seeks to create dynamic synergies between national and regional trade policies, in addition to achieving greater inclusion of SPECA countries in the global economy and the WTO-led Aid-for-Trade initiative. Other than Afghanistan, the other SPECA countries (which are all ECE members) have up to this point been largely excluded from the Aid-for-Trade initiative. To provide for proper follow-up monitoring and support of trade development initiatives, a SPECA Regional Aid-for-Trade Implementation and Monitoring Council was launched. The Council, working closely with the SPECA Project Working Group on Trade, will bring together beneficiary countries, multilateral and bilateral donors and United Nations agencies working on trade issues, to ensure that all regional trade development priorities identified by SPECA countries are adequately supported by projects and funding.

53. Transport costs are especially high in Commonwealth of Independent States countries because they are disadvantaged geographically, being either landlocked, outside the main trade routes, or having a low density of economic activity (as in Central Asia). In addition, they lack modern infrastructure and have fragmented transport markets that prevent economies of scale. Generally, there appears to be a "virtual border" between Central Europe and the Commonwealth of Independent States with transport times and costs per kilometre continuing to rise as one goes further eastward. The average speed of rail transport (which accounts for 90 per cent of Commonwealth of Independent States freight transport) is 60 km/hour in the European Union versus 45 km/hour in the Commonwealth of Independent States, while the differential is even greater for truck transport (70 km/hour in the European Union and only 37.5 km/hour in the Commonwealth of Independent States). The current institutional structure of the transport network in Central Asia is an important source for the higher transport costs; that includes the ownership structure as well as their pricing policies. The relatively low levels of railway labour productivity indicate that there is considerable scope for improvement in a number of the European emerging economies.

54. Improved transport infrastructure is necessary but not sufficient for the European emerging economies to reap greater benefits from trade. Improved trade and transport facilitation within regional entities and at their external borders are equally important. WTO plays a key role in the facilitation of international trade in goods and services and the ECE complements it by administering 57 United Nations legal instruments for the facilitation of international transport and the reduction of trade barriers. Proper implementation of a number of those instruments would help to reduce the currently high trade costs in the Commonwealth of Independent States.

55. Trade in many of the Commonwealth of Independent States countries is hampered by burdensome administrative costs; that includes the large number of documents required for exporting and importing. Most of the Western European countries require about three to five documents to import or export a standardized cargo of goods. However, Azerbaijan requires 14 documents for importing, while Kazakhstan requires 10 for exporting. The World Bank *Doing Business* report ranks countries in terms of the ease of trading based upon the time and difficulty (i.e., number of documents, etc.) in obtaining customs clearances. In its 2009 report, four (Azerbaijan, Kazakhstan, Tajikistan and Uzbekistan) of the 10 most difficult countries in obtaining customs clearance are in the Commonwealth of Independent States. Differences in technical standards also act as technical barriers to trade; the creation of common standards or acceptance of the principle of mutual recognition of the others' standards would contribute to improving export opportunities and lowering the costs of imports. The failure to make more progress is often blamed on special interest groups, poor governance, corruption, or simply the failure of national Governments to focus attention on these issues. Nevertheless, in recent years a number of Governments in Europe and Central Asia were able to reduce significantly the time and cost of trading across borders with the aid of reforms that improved customs procedures. Such countries include a number of European Union member States (Latvia, Lithuania, Portugal, Slovakia, Spain), South-East European countries (Albania, Bosnia and Herzegovina, Croatia, Montenegro, the former Yugoslav Republic of Macedonia) and Commonwealth of Independent States countries (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Ukraine).



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Overview of economic and social conditions in Africa, 2011

Summary

African economies continued to recover from the financial and economic crisis with a growth in gross domestic product of 4.7 per cent in 2010, up from 2.3 per cent in 2009. Key growth factors in Africa included rising commodity prices and exports, sustained countercyclical fiscal and monetary policies and increasing domestic demand in many countries, increased foreign direct investment in extractive industries and aid flows, and more diversified exports, including manufactures, trade services and tourism. Growth performance continued to vary considerably across subregions and countries, with oil-exporting countries growing at 5.2 per cent in 2010 compared with 4.0 per cent for oil-importing countries. While both fiscal and current account deficits widened in 2010, generally macroeconomic balances remained within sustainable levels and inflation rates declined in most African countries and for the continent as a whole. The continent's growth prospects are likely to be significantly affected by the ongoing political unrest in North Africa and other subregions. Thus, Africa's growth rate in 2011 is likely to fall considerably short of the 5.1 per cent forecast at the beginning of the year. Meanwhile, growth has been largely jobless and progress towards reducing poverty and achieving other Millennium Development Goal targets remains slow, especially in sub-Saharan Africa.

* See E/2011/1.

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I. Introduction

1. Africa has sustained and strengthened the economic recovery that started in the aftermath of the recent global crisis with an average gross domestic product (GDP) growth rate of 4.7 per cent in 2010 compared with 2.3 per cent in 2009. Real GDP per capita also expanded in 2010 by 2.4 per cent for the continent as a whole. The economies of oil-exporting countries expanded more strongly than those of oil-importing countries. Notwithstanding downside risks, growth prospects remain optimistic for Africa, with an expected average growth rate of 5 per cent in 2011.

2. The recovery was underpinned by a number of positive factors, including the rebound of export demand and commodity prices; increased inflows of foreign direct investment (FDI), especially in extractive industries and aid; a return of tourism; investment in infrastructure associated with countercyclical policies adopted by many African countries; increased activities in the service sector, particularly in telecommunications; higher consumer demand; and good harvests in some countries. The two distinguishing features of the ongoing recovery as opposed to previous upturns have been its swiftness and remarkable strength.

3. While notable variations exist across countries, inflation rates have generally declined in 2010. Accordingly, monetary policy has been accommodative or neutral in most African countries. Budget deficits increased as a result of expansionary fiscal policies, prompting some countries to tighten fiscal policy and consolidate their budgets. Current account deficits widened moderately in 2010, partly owing to the robust import growth fuelled by bold public investment, rising private demand and increasing food and energy prices.

4. The continent's economic rebound has yet to translate into meaningful reduction in unemployment, which continues to be high, particularly among young people and vulnerable groups. High unemployment and food prices have instigated political and social unrest in some African countries such as Algeria and Tunisia. The low employment content and poor social outcomes of Africa's growth are the result of a lack of meaningful economic diversification and continued heavy dependence on commodity production and exports. This highlights the need for promoting economic transformation for Africa to accelerate and sustain growth and achieve its social development goals.

II. Developments in the global economy and implications for Africa

5. Following the global financial and economic crisis, the world economy demonstrated signs of recovery in the first half of 2010. Such signs weakened somewhat in the second half of 2010. Growth divergences continued to persist in 2010, particularly between the developed economies on the one hand and developing and emerging countries on the other. According to the International Monetary Fund (IMF), growth in developed economies, in particular the United States of America, European Union countries, Australia and Japan, remained sluggish. Unsustainable budget deficits and weakened fiscal positions caused by the bail outs of financial institutions led to a severe sovereign debt crisis in the European Union in 2010.

6. Some European countries responded to this sovereign debt crisis by adopting stringent fiscal consolidation measures, which partly consisted of cutting back on public spending. Fiscal consolidation took away many public-service sector employment opportunities, worsening the already high unemployment rate, and acted as a drag to economic growth in the Euro area and the global economy. Developing and emerging economies, especially China and India, rebounded strongly. Their growth is also expected to slow in 2011 however.

7. Developed economies saw a decrease in trade deficits from 2008 and 2009. This was driven by the fact that imports contracted more significantly than exports. It is estimated by IMF that the ratio of current account balances to GDP for developed economies will remain relatively stable, with a surplus of 0.3 per cent in 2010 and 0.1 per cent in 2011. These developments conceal some differences across this group of countries.

8. The trade deficit in the United States stood at 3.2 per cent in 2010 but is expected to decline to 2.6 per cent in 2011. This partly reflects weak household spending. Owing to economic uncertainty and deteriorated balance sheets, households in the United States are cutting their spending, which could reduce the trade deficit. The current account of the Euro area, as a whole, will be nearly balanced in 2010 and 2011, with diverse records within the area. Germany continues to run a considerable current account surplus, while Greece and Portugal, which were at the centre of the Euro area sovereign debt crisis, recorded double-digit deficits in 2010.

9. Current account balances in emerging and developing countries worsened in 2010. The same is expected in 2011, due partly to the high growth of imports fuelled by the fiscal stimuli implemented in these countries. There are, however, some exceptions. China recorded a current account surplus of 4.7 per cent of GDP in 2010. This surplus is expected to widen to 5.1 per cent in 2011, although its size will continue to be lower than the double-digit levels recorded before the economic and financial crisis.

10. During the global financial crisis, decreased demand from developed economies caused the commodity price index to drop by 56 per cent from its highest point in July 2008. A rebound in commodity price indices began in February 2009. By the end of September 2010, the index had recovered by nearly 53 per cent from its lowest point in 2009, thanks to increased demand from rapidly growing emerging and developing economies.

11. Most commodity prices increased in 2010, but the variations and sensitivity to economic shocks varied across commodities. Food prices have been the most stable, whereas metal prices had the largest fluctuation, followed by energy. Oil prices are highly correlated with the prices of other commodities. With oil prices rising steadily, African oil-exporting countries are expected to enjoy a firm and steady economic recovery in 2011.

12. Developments in the global economy have significant implications for African countries generally, although the specifics in terms of the direction and magnitude of impact naturally vary across countries. Higher commodity demand and prices spurred rapid growth in Africa's exports and output in 2010. However, the continent's narrow production and export structures are likely to maintain their historical vulnerability to external shocks.

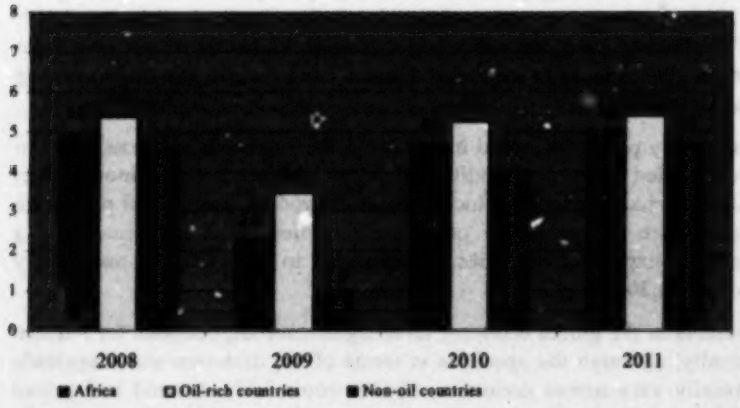
13. The nominal increase in commodity prices has led to an improvement in the terms of trade as well as external balances for many African commodity-exporting countries in 2010. Most oil exporters on the continent are expected to continue running current account surpluses in 2011. By comparison, Africa's oil-importing countries will see the state of their current account balances worsen. Rising grain prices will also pose daunting challenges to efforts to eradicate hunger, especially in low-income African countries that are heavily dependent on food imports.

14. The flow of remittances to Africa did not drop as much as expected but its projected growth of 5 per cent over the period 2010-2011 is much lower than the pre-crisis growth rates. Similarly, official development assistance (ODA) to Africa might decline owing to difficult economic conditions in some donor countries, with significant negative consequences for Government spending in many African countries in 2011 and beyond.

III. Economic performance in Africa in 2010

15. Economic activity rebounded across Africa in 2010. While most economies regained some of the dynamism lost in 2009, the pace of the recovery varied across countries and subregions. Oil-exporting countries expanded more strongly (5.4 per cent) than oil-importing countries (3.9 per cent) perpetuating the trend of the last decade (see figure I). One important feature of growth in oil-exporting countries is the growing prominence of the non-oil sector, with a sustained increasing share in GDP growth over the past few years. The strength of the non-oil sector reflects ongoing efforts in the oil-exporting countries to diversify their economies. In fact, rapid growth in the non-oil and non-mineral sector has been registered by both oil-producing and non-oil-producing countries and if this is sustained, Africa is poised to become the fastest-growing continent in the second decade of the twenty-first century.

Figure I
Growth in Africa, oil-exporting vs. oil-importing countries, 2008-2010
(Per cent)



Source: Economic Commission for Africa (ECA) calculations based on ECA and Department of Economic and Social Affairs databases, November 2010.

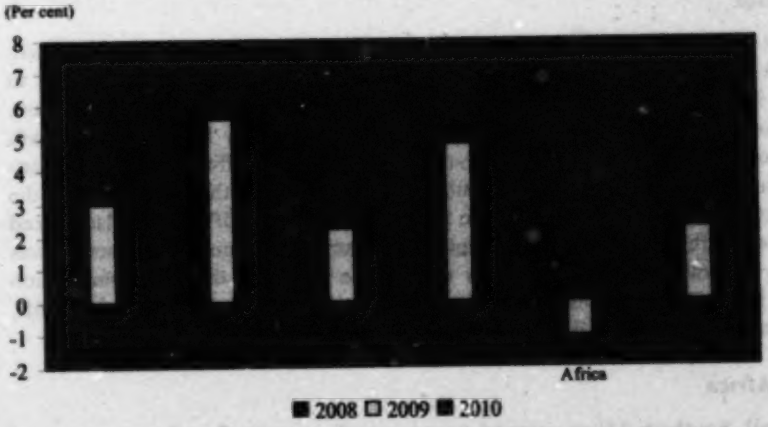
16. Africa's recovery is also associated with a notable increase in private capital flows. FDI rebounded as a result of growing interest in the mineral sector along with foreign investment in services and manufacturing sectors. Remittances continued to represent the second most important source of capital flows to Africa after FDI, amounting to about 7 per cent of Africa's GDP in 2010. Aid flows to Africa grew by 4 per cent in 2010 despite economic difficulties faced by many donor countries, while some African countries continued to benefit from debt relief.

17. Many African countries maintained expansionary fiscal and monetary policies in 2010 with sound and sustainable internal and external balances. This reflected continued good economic management on the continent. Improved macroeconomic management, including exchange rate management and budgetary allocations, was among the factors that assisted many African countries, including some countries with relatively limited natural resources, to achieve and sustain high growth with notable diversification of production and exports over the past decade.

18. Overall, export diversification covered both traditional and non-traditional products such as flowers, manufactures, trade services and tourism. Africa was the only world region to achieve a tourist growth rate of 9 per cent in 2010 thanks partly to the momentum created by the worldwide publicity of the 2010 football World Cup in South Africa, and economic recovery in tourist-sending countries. The outlook for 2011 tourism growth is expected to be positive.

19. In addition to differences between oil-exporting and oil-importing countries, Africa's aggregate GDP growth figures hide important variations across subregions and countries. Among the five subregions of Africa, East Africa (6.8 per cent) and West Africa (6 per cent) were the two best performing in 2010, followed by North Africa (4.7 per cent), the main oil-producing subregion, Central Africa (4.3 per cent) and Southern Africa (3.3 per cent) (see figure II).

Figure II
Subregional growth performance, 2008-2010



Source: ECA calculations based on ECA and Department of Economic and Social Affairs databases, November 2010.

West Africa

20. Economic performance improved in most West African countries in 2010. Important growth factors included high oil prices and revenue as well as increased non-oil activity (Nigeria), increased activity in the construction and services sector (Ghana), strong performance of the agricultural and mining sectors (Sierra Leone) and increased rubber export earnings (Liberia). Guinea and the Niger recorded positive GDP growth rates and posted positive rates in 2010.

21. However, their growth turned out to be weak in view of continued political disturbances and insecurity that limited opportunities for a significant economic rebound. In 2010, GDP growth slowed down in the second largest economy in the subregion, Côte d'Ivoire, partly owing to power shortages and the political uncertainty that prevailed in the country before and after elections in November. The dispute over the presidential election results and its political and security repercussions are likely to undermine the country's growth performance in 2011 as well.

East Africa

22. East Africa sustained the same level of robust growth as in 2009 thanks to the impressive growth performance of such countries as Ethiopia, Rwanda, Uganda and the United Republic of Tanzania. These countries recorded notable expansion in their industrial services sectors, especially the telecommunications subsector and construction. Additional growth factors in the fastest growing economies in the subregion included increased agricultural output (Ethiopia), rising mining output (United Republic of Tanzania) and continued robust investment in donor-funded infrastructure development (Ethiopia and United Republic of Tanzania). Elsewhere in the subregion, growth recovery also gathered momentum in 2010, as in Kenya and Mauritius. The political stalemate continued to adversely affect economic activity in Madagascar, with its GDP declining for the second consecutive year.

North Africa

23. Most North African countries recovered strongly in 2010. GDP growth rebounded markedly in the Libyan Arab Jamahiriya and Mauritania, thanks to increased Government spending and robust activity in sectors such as agriculture, construction and mining in the latter. The Egyptian economy has kept its growth momentum in recent years, as the positive demand spill-over effects of expansionary fiscal policy continued to unfold. Similarly, economic growth accelerated in the Sudan, partly reflecting robust growth in its services sector. GDP growth also picked up in Tunisia with rising industrial output and investment, although the rebound was limited by the modest recovery in its main trade partners, the European Union countries. Morocco's economic growth, although still relatively robust, tapered off, as agricultural production fell after the bumper 2008/09 harvest.

Southern Africa

24. Overall, Southern Africa enjoyed strong growth over the first three quarters of 2010, thanks both to the football World Cup dividends (South Africa) and to robust exports and increased activities in the mining and manufacturing sectors. However, this growth momentum lost some strength during the fourth quarter of 2010, as private consumption weakened further. In 2010, Malawi, Mozambique and Zambia

maintained growth rates of 6 per cent or more, owing to rising mining output in all three countries and bumper harvests in Mozambique and Zambia. Economic activity fully recovered in Botswana and Namibia, where GDP growth rates exceeded or reached pre-crisis levels, thanks mainly to global demand for minerals. Zimbabwe also maintained its recovery momentum. Its growth benefited from a number of factors, including the improved macroeconomic environment, increased industrial capacity and manufacturing output, and tourism.

Central Africa

25. On average, growth rates were modest in Central Africa with a GDP growth rate of 3.7 per cent in 2010 up from 2.5 per cent in 2009. All the Central African countries, except Congo, expanded by less than 5 per cent in 2010, owing mainly to a lack of export diversification, continued fragility in the political and security situation in the Central African Republic and declining oil production in Equatorial Guinea, Gabon and Cameroon, despite the continued strong expansion of their non-oil sector and increased mining activity. Oil output in these countries declined because of falling production capacity in some of the existing oil fields.

Africa's recovery largely jobless

26. Anecdotal evidence and parsimonious up-to-date data on unemployment suggest that job growth and creation was disappointing overall on the continent in 2010, especially in light of the strong output growth recovery. This perpetuates an essential feature of the recent growth spell across Africa. In addition to education quality, the narrow-based economic structure of the African countries has contributed to the high levels of unemployment.

27. Job creation remains limited in countries where much of the economic upturn is driven by capital-intensive extractive sectors with few forward and backward linkages with the rest of the economy. The narrow growth base, rapid population growth and labour market imperfections imply that Africa's growth rates have consistently fallen behind the growth rate needed to create adequate employment and reduce poverty.

28. Job creation also remains limited in some countries owing to the rather modest recovery, with the pace of economic growth far lower than that required to make a significant dent in unemployment. South Africa is a case in point, where thousands of the jobs lost when its economy dipped into recession in 2009 were not recovered in 2010 because of the modest speed of growth.

29. The unemployment rate did decline in a few African countries, such as Egypt and Mauritius, but only moderately owing to the limited strength of the growth recovery and the nature of the sectors that supported it. Unemployment among young people in Africa has remained at the high rate of about 18 per cent for the past decade and young people continue to face severe hurdles in gaining decent employment. This particularly grave unemployment situation among young people is a cause of concern. The recent wave of political instability in North Africa illustrates the severity of the situation.

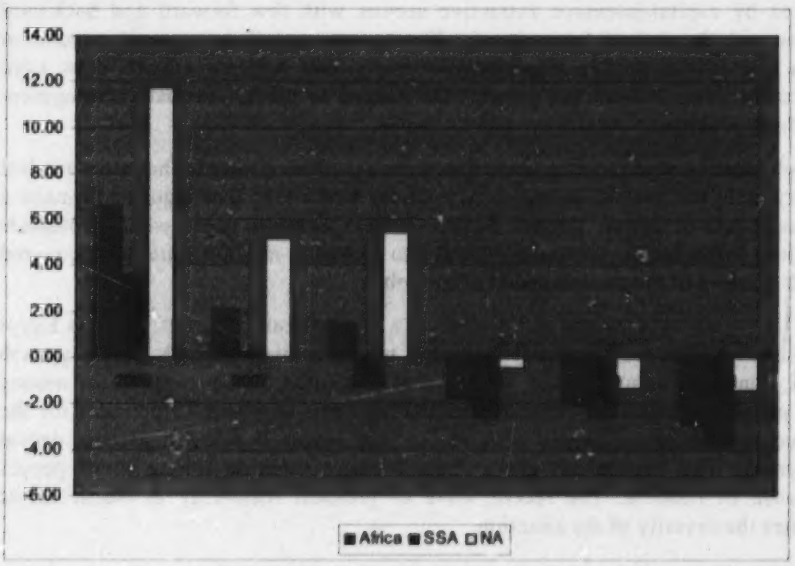
IV. Macroeconomic imbalances driven largely by commodity shocks

Slight deterioration in current account deficits

30. On average, the current account deficit widened slightly in Africa in 2010, from 1.7 per cent of GDP in 2009 to 2.1 per cent in 2010 (see figure III). Current account deficits widened moderately in oil-importing countries owing partly to robust imports growth fuelled by bold Government-led investment programmes, rising private demand and increasing oil and energy prices. As recovery took hold in major trading partners, however, the export earnings of this group of countries rebounded, although at a much slower pace than that of imports. Overall, oil-importing countries emerging from conflict (Burundi, the Democratic Republic of the Congo and Liberia) and those belonging to the Southern African Customs Union (SACU) posted the largest current account deficits.

31. The key factors behind this include increased imports of capital goods and food coupled with limited export capacity in post-conflict countries, and large deficits and severe reductions in transfers in SACU countries owing to lower payments from this customs union. The average for oil-importing countries conceals the shrinking current account deficits of some mineral-producing countries such as Burkina Faso, Mali and the United Republic of Tanzania. These countries benefited from improved terms of trade thanks in part to the high price of gold, one of their main exports.

Figure III
Trends in current accounts, 2008-2010
(Per cent)



Source: ECA calculations based on ECA and IMF databases, November 2010.
Abbreviations: SSA = Sub-Saharan Africa; NA = North Africa.

32. Aside from gold-producing countries, countries that witnessed improvements in their current account balances were mostly oil-exporting countries. The external position of this group of countries improved in 2010, thanks to rising oil demand and prices. Besides increased export earnings, rising inflows of current transfers associated with IMF disbursements also helped current account balances to shift into surplus in 2010 in some countries.

33. The recovery of private inflows, especially of FDI, to some of the most advanced African economies, partly driven by interest and growth differentials between these countries and the developed countries, has led to nominal currency appreciations in varying magnitudes. Such an appreciation combined with relatively high inflation rates compared with those of their trading partners led to a slight real exchange rate appreciation in such countries as Egypt, Nigeria and South Africa in 2010.

Generally subdued inflation across the continent

34. Africa's inflation decreased from 8.3 per cent in 2009 to 7.2 per cent in 2010 and is expected to decline further to 6.4 per cent in 2011. This trend reflects the increased supply of agricultural products in some countries, the strength of some currencies, excess capacities, and competitive pressures across the continent. Consumer prices declined in many countries, mostly in East and Southern Africa (e.g. Uganda and Zambia), partly owing to a significant moderation of food prices before the last quarter of 2010. Good weather conditions in these countries contributed to good harvests and increased food supply.

35. Inflation also fell in such countries as Ghana, where the stability of the domestic currency, the Ghanaian Cedi, more than offset the inflationary pressures associated with higher Government expenditure and wage increases. Elsewhere, intense competition in the telecommunications sector led to a drastic reduction in the price of services in such countries as Gabon, while excess capacities in the productive sectors halted consumer price increases in South Africa.

36. While inflationary pressures abated in the majority of African countries, price escalations were observed in a few countries, including Mozambique and Sierra Leone. In general, inflationary trends in 2010 varied significantly across countries owing to different and sometimes country-specific factors. These factors included, among other things, increased domestic demand in the Congo, the Libyan Arab Jamahiriya and Nigeria for instance, robust public spending in Algeria, the lagged effects of currency depreciation of late 2009, introduction of the goods and services tax in Sierra Leone, and exchange rate depreciation in Mozambique and the Sudan.

37. Food prices in Africa remained stable and even declined in some cases before the last quarter of 2010. This contrasts with the situation that prevailed in the international market where food prices, especially the prices of wheat and rice, generally increased owing to higher demand and supply shocks. Floods in Australia, Thailand and Viet Nam caused delays and reductions in the quantity and quality of their harvests. Higher agricultural production kept prices stable in most sub-Saharan African countries. Only in North Africa did prices significantly increase, because of its dependence on wheat imports.

Accommodative or neutral monetary policy stance in most economies

38. In view of subdued inflation and the need to stimulate domestic demand and nurture the ongoing recovery, the monetary policy stance continued to be accommodative or neutral in the majority of African countries. For example, the benign inflation outlook provided enough leeway to the South African Reserve Bank to sustain monetary easing with the aim of supporting the recovery.

39. In contrast, monetary tightening was observed in the Democratic Republic of the Congo, Ethiopia and Nigeria. Central banks in the Democratic Republic of the Congo and Ethiopia limited the growth of the money supply as a means of tightening inflation. To reduce inflationary pressures as a result of the strong performance of the real sector and increased Government spending, the Central Bank of Nigeria raised its key policy rates in September 2010 and embarked on open-market operations to control liquidity.

40. One of the challenges of monetary policy, particularly in some of the countries that have expansionary or neutral monetary policy stances, was the weak effect of reduced interest rates on the real sector. Despite relatively low interest rates in many countries, credit to the private sector still stagnated, as commercial banks adopted cautious attitudes amid uncertainty in global economic conditions.

Contribution of continued fiscal loosening to the deterioration of fiscal balances

41. Africa's overall fiscal balance deteriorated slightly in 2010, from a deficit of 5.7 per cent of GDP in 2009 to 5.8 per cent in 2010, owing mainly to sustained increases in public spending. Fiscal spending continued to be robust in the majority of countries, as Governments maintained stimulus-related expenditures to cushion the lagged effects of the global economic and financial crisis and support the ongoing recovery. In addition, relatively strong Government spending reflected new and costly public-sector pay regimes as well as fiscal injections arising from electioneering expenses as almost a dozen elections took place in 2010.

42. The continued loose fiscal stance was also the manifestation of ongoing efforts geared towards bridging infrastructure gaps, an essential pillar of the medium-term development plans formulated and implemented by a number of countries. Such efforts took hold amid a growing consensus over the important role and place of the State in steering African economies onto sustainable development paths, especially by contributing to building and strengthening productive capacities.

43. Despite economic recovery and increased growth rates, most countries continued to face revenue shortfalls of varying magnitude in 2010, as public spending was maintained at relatively high levels. Countries belonging to SACU, especially South Africa, were among those that experienced the most significant revenue shortfalls due to the sharp decline in SACU revenue.

44. Similarly, worsening fiscal balances and concerns over fiscal and debt sustainability prompted some countries to shift the objective of fiscal policy from short-term demand management to medium-term fiscal sustainability. Mauritania and the Sudan limited the widening of their fiscal deficits through a combination of increased Government revenue, achieved by strengthening their customs and tax administration capacities, and a reduction in discretionary spending. Under its 2010/11 budget, which was unveiled in February 2010, South Africa planned to

implement a fiscal consolidation programme that would target a real growth of fiscal spending of 2 to 3 per cent per year.

V. Trends in social development in Africa in 2010

45. Africa's economic rebound and sustained growth are yet to translate into commensurate progress towards social development, including the many indicators laid out in the Millennium Development Goals. This is not to say that Africa has not made any progress. In fact, most African countries have positively progressed at a varying pace towards all Millennium Development Goal targets, with notable reductions in undernourishment, increased primary school enrolment and improvement on some health indicators. However, poverty rates, maternal mortality rates and unemployment rates have remained extremely high.

Unsatisfactory progress towards achieving social development goals in Africa

46. Overall progress towards achieving the Millennium Development Goals remained mixed in most African countries in 2010 and subject to formidable challenges. The most notable lag in social development in Africa was the slow progress towards reducing absolute poverty. Poverty rates remained chronically high and the positive economic growth did not result in meaningful job creation and higher income for the poorest segments of the population. The proportion of employed people living on less than $1.25 a day increased from 58 to 64 per cent between 2008 and 2009.

47. In addition, the global financial crisis resulted in declining output per worker. Some 63.5 per cent of the working population in sub-Saharan Africa is at risk of falling below the extreme poverty line in 2011. Only if African countries are able to translate the relatively strong economic growth, both in total GDP and GDP per capita, into employment creation and benefits for the poorest sectors of society can Africa make significant progress towards reducing absolute poverty.

48. Regarding eradication of extreme hunger, many African countries recorded a decline in malnutrition over the past year. The proportion of the population below the minimum level of dietary energy consumption has fallen from 30 to 24 per cent in Africa, excluding North Africa, where less than 5 per cent of the population is undernourished. This positive trend, however, remains threatened by rising international food prices.

49. Important progress has also been made across the continent regarding education, where the primary school enrolment ratio has increased by 18 per cent between 1999 and 2009. As a noteworthy case, the abolition of primary school fees in Burundi resulted in a threefold increase in primary school enrolment since 1999, reaching 99 per cent in 2009.

50. However, many African countries are confronted with the challenge of improving the quality of education. Completion rates of primary school and the pupil to teacher ratios, both proxies for quality provisions, are inadequate. Despite some improvements, the completion rates are around 60 per cent in most countries and class size has remained very large. The disproportionate focus on primary education compared with the skills developed in higher education needed by the labour market is one of the major drivers of unemployment. This has been

acknowledged by the African Union in resolutions on the Second Decade of Education for Africa (2006-2015), which considers all levels of education as crucial elements of economic and social development.

51. There were also improvements in empowerment of women and gender equality in 2010. Gender parity in primary schools was on track, although it was seriously off track for higher levels of education. One of the key successes in the empowerment of women related to enhanced participation of women in decision-making and more equality in access to education, where progress has been made across countries. Some Southern African Development Community countries and the East African Community made notable progress by achieving 30 per cent or more participation of women in Parliament. Some of the examples that can be cited, based on data compiled by the Inter-Parliamentary Union, include Rwanda (56.3 per cent), Mozambique (39.2 per cent), South Africa (44.5 per cent) and Uganda (31.5 per cent). Rwanda's record level of 56.3 per cent in the lower house surpasses the Scandinavian average of 45 per cent. The Government of Mozambique used a quota system (30 per cent minimum at all levels) to ensure fair representation of women in politics. Gender inequality remained a concern, however, especially in relation to employment and income.

52. Many African countries have shown some progress towards achieving certain health-related Millennium Development Goals. The aggregate under-five mortality rate dropped from 180 to 129 per 1,000 live births between 1998 and 2008. Eritrea, Ethiopia, Liberia and Madagascar have all reduced their under-five mortality rates by 50 per cent or more. However, the highest rates of child mortality in the world continue to be found in sub-Saharan Africa. In 2009, one in eight children died before their fifth birthday. All 31 countries with under-five mortality rates exceeding 100 per 1,000 live births in 2009 were in sub-Saharan Africa. So although the sub-Saharan Africa under-five mortality rates have declined by 28 per cent since 1990, the improvement is insufficient to meet the targets set in the Millennium Development Goals.

53. In terms of maternal health, progress also remains mixed. The latest available data show an overall decline in maternal mortality worldwide. Central and East Africa have shown significant progress, with a 20 and 26.4 per cent reduction in maternal mortality between 1980 and 2008 respectively. Southern Africa, however, has experienced an increase in maternal mortality rates, from 171 deaths per 100,000 live births in 1990 to 381 per 100,000 in 2008. West Africa has also seen an 8.1 per cent increase over the same period. As a whole, sub-Saharan Africa experienced a reduction of only 3.3 per cent in maternal mortality rates since 1980, nowhere near the progress necessary to achieve Millennium Development Goal 5. Three of the six countries that account for 50 per cent of all maternal deaths globally are in Africa, namely the Democratic Republic of the Congo, Ethiopia and Nigeria. Unless Governments put maternal health as a central focus of their health agenda, Africa will continue to have the highest burden of maternal deaths worldwide.

54. Improvements in battling the HIV/AIDS pandemic continue to be significant. In 22 sub-Saharan African countries, HIV incidence fell by over 25 per cent between 2001 and 2009. At the end of 2009, 37 per cent of adults and children eligible for antiretroviral therapy were receiving it, compared with only 2 per cent seven years earlier. AIDS-related deaths decreased by 18 per cent in Southern Africa over the

past year as well. Furthermore, there has been pronounced progress in reducing the incidence and impact of HIV among children under 15, with 32 per cent fewer children newly infected and 26 per cent fewer AIDS-related deaths among children. However, while access to antiretroviral therapy and prevention efforts have improved, the total number of people living with HIV in Africa has remained high at 22.5 million people in 2009.

55. Progress in access to safe drinking water and improved sanitation, which have a direct bearing on health status, has been steady across Africa. In 2008, nine African countries showed a marked improvement in coverage of safe drinking water over coverage levels prevailing in 1990. For example, Mauritania improved water supply coverage from approximately 40 per cent to about 60 per cent between 1990 and 2008. Likewise, Uganda improved coverage from 40 per cent to 80 per cent during the same period. Despite this progress, evidence showed that inequality in access and outcomes exists, based on income quintiles and geographical location. Average access to safe drinking water services was 3.7 times higher for urban households compared with their counterparts in rural areas.

56. In sum, although Africa has made important progress towards some key social development goals, overall progress remains mixed, and countries face many challenges in continuing on the right track. It is of concern that sustained economic growth in many African countries has not translated into significant gains in social development. Nevertheless, high and sustained growth is essential for African countries to enhance efforts at reducing poverty and achieving other key social development goals.

Factors affecting progress towards achieving the Millennium Development Goals and other social development goals

57. The varying rate of progress towards achieving the Millennium Development Goals and other social development goals is influenced by three major factors. First, the pace and character of growth must be addressed. As indicated earlier, in most countries growth rates continue to fall below the levels required for Africa to achieve the Millennium Development Goals. Moreover, growth in Africa remains heavily dependent on the primary commodity sector, which has low employment elasticity. Second and perhaps foremost in some cases, progress towards social development goals requires strong political commitment. Governments must place social development high on their agenda in order to harness economic growth successfully for social progress.

58. Likewise, adequate resource allocation is necessary. This is demonstrated by the progress made in education due to Government commitment to increasing primary school enrolment. Countries which allocate at least 50 per cent of their education budget to primary education have reported the fastest rate of progress. In Mauritania, for example, primary enrolment rates increased from about 38 per cent in 1991 to 81 per cent in 2007 owing in part to an approximate 60 per cent allocation of total educational expenditure to primary education.

59. Third, Africa is a highly unequal continent on many indicators, second only to Latin America. In addition to historically high inequality between rural and urban areas, the continent is characterized by high horizontal inequalities, reflected in the exclusion of many social groups from actively participating in the social, economic and political processes in many countries. High inequality and the fact that growth

is concentrated in enclave sectors reduce the impact of economic growth on social outcomes.

60. Indeed, a critical challenge is reducing inequality in access to social services and thus in development outcomes, including health and education. There is a serious risk of the poor being left behind, since most of the targets are national averages. These inequalities explain a great deal of the region's slow progress in attaining the health Millennium Development Goals, as there is strong evidence to suggest that more egalitarian societies tend to be healthier.

61. The cost incurred in accessing public goods is also an important component in assessing progress towards social development goals. Slow progress towards some of the Millennium Development Goals, most notably health services, demonstrates this phenomenon. Health targets that have seen the least progress have a significant cost to the poor consumer. Donor funding for specific diseases, through vertical funds, seems to have a positive impact on rates of progress. Predictable and adequate funding to tackle, for example, HIV/AIDS, hinges on providing free treatment and has a positive effect on progress towards social development goals. The same phenomenon can be seen in the case of tuberculosis and malaria.

62. To sum up, poverty remains a critical social development factor in Africa. Thus, tackling poverty is essential for achieving social development objectives. One of the strategies to escape poverty is employment. The low employment elasticity of growth implies that recent growth in Africa has been largely jobless. The continent therefore needs to promote broad-based and shared growth to reduce unemployment and poverty and enhance progress towards achieving other social development objectives.

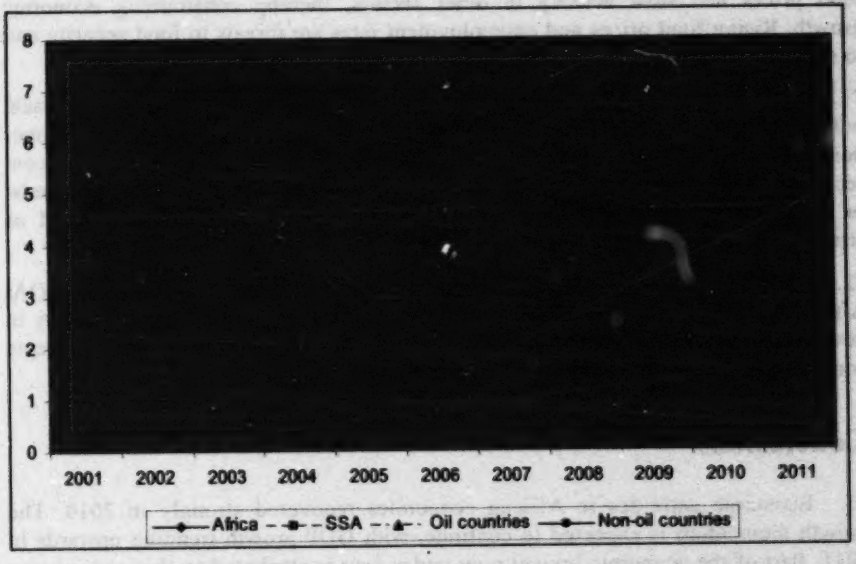
VI. Favourable outlook for 2011, barring exogenous shocks

63. African economies are expected to show continued signs of strengthening and broadening in 2011, with Africa's GDP growth rate accelerating from 4.7 per cent in 2010 to 5 per cent in 2011 (see figure IV). This upturn mirrors the continued strong economic performance in both oil-exporting and oil-importing countries, owing to the benefits of the growth factors discussed in the preceding sections. The GDP growth rate for oil-importing countries is forecast to accelerate to 4.6 per cent in 2011, up from 4.0 per cent in 2010, while that of oil-exporting countries should reach 5.4 per cent, roughly the same as in 2010. Continued investment in infrastructure and in the production of metals and minerals for export is expected to underpin economic growth in some oil-importing countries.

64. Turning to the subregions, West Africa is poised to remain one of the fastest growing on the continent, with GDP expanding by 6.4 per cent in 2011. This strong economic performance owes much to the impressive growth of Nigeria, Ghana and Liberia, expected to be by more than 7 per cent, due to various factors. Growth factors are likely to include the ongoing dynamism of the non-oil sector in Nigeria, the commercial exploitation of oilfields in Ghana, and increasing FDI in the mining sector in Liberia. Growth in West Africa is likely to be adversely affected by the political conflict in Côte d'Ivoire that followed the presidential elections in November 2010 however.

65. East Africa is expected to be another important growth pole in Africa in 2011 (6.4 per cent). The GDP growth rates of Ethiopia and Mozambique are forecast at about 7 per cent, while that of Uganda is expected to be close to 7 per cent. North Africa, Central Africa and Southern Africa will follow, with GDP expected to expand by 5.2 per cent, 4.0 per cent and 3.8 per cent respectively.

Figure IV
Gross domestic product growth in Africa, 2001-2011
(Per cent)



Source: ECA calculations based on ECA and Department of Economic and Social Affairs databases, November 2010.
Abbreviation: SSA = sub-Saharan Africa.

66. While the expected growth rates are markedly higher than those attained over the past two years, they remain slightly lower than those observed prior to the recent global financial and economic crisis. Further, these rates are still below the levels needed to make a significant impact on unemployment and poverty reduction across the continent.

67. The ongoing economic recovery is expected to take place in the context of a moderate inflation outlook. Inflationary pressures are expected to recede or remain flat in the majority of countries, as private demand pressures are likely to be moderate and recourse to central bank overdraft facilities to finance fiscal deficits will be scaled down in a number of countries.

68. Overall, the positive outlook for 2011 is subject to many potential downside risks and uncertainties. One risk to the outlook relates to the pace and duration of growth in Africa's economic partners, in particular emerging economies such as China and India, which affect the demand and price for African exports. At the same time, this leads African countries to once again deepen their specialization in the primary sector. The strength of the recovery in Europe and the United States will

also influence the pace of African export growth, tourism receipts, remittances and ODA, thereby affecting short-term growth prospects.

69. With 17 presidential and parliamentary elections scheduled in 2011, another risk pertains to the possible political disturbances and their ruinous impact on economic activity. Also, political unrest and change in some countries such as Tunisia and Egypt are likely to have notably adverse effects on growth in North Africa in 2011.

70. Adverse weather conditions could also depress agricultural output, increase food prices and slow activity in other sectors, thereby constraining economic growth. Rising food prices and unemployment rates are threats to food security and to social and political stability in Africa as a whole.

71. Africa's medium-term growth prospects are likely to be influenced by fiscal policy stances. In particular, premature and severe fiscal tightening will hamper domestic demand and compromise the chances of consolidating the nascent recovery. Fiscal policy needs to be redesigned to strengthen employment and assist in the transition towards promoting infrastructure and job creation as well as structural transformation for more sustained economic and social development.

72. Finally, another risk relates to the availability of financing, especially ODA. Although ODA flows to Africa recovered somewhat in 2010, the fragile recovery in developed countries and the possible threat of a double-dip recession create considerable uncertainty about the future volume of ODA flows.

VII. Conclusions

73. Economic activities in African economies recovered strongly in 2010. The growth momentum is expected to continue, with GDP growth trending upwards in 2011. Part of the economic revival now under way is attributed to the continuation of supportive fiscal and monetary stances. Relatively robust public spending assisted economic growth, but led to increased fiscal deficits. The external position also weakened, although only slightly.

74. Strong public spending and rising fiscal and current account deficits occurred as African Governments felt the urge to mitigate the economic and social effects of the global crisis. The crisis has clearly highlighted the need for more effective policies for economic transformation, employment generation, food security and poverty reduction on the continent. In addition to short-term countercyclical fiscal and monetary policies, incentives for investment in the non-commodity sectors that promote economic transformation and dynamic job creation must be included.

75. The need for such policies partly explains why interest in development planning and the role of the State in economic and social development has resurged in Africa in recent years. The State needs to play a more strategic development role that involves not only building and strengthening productive capacities through the removal of growth-inhibiting factors, including infrastructure bottlenecks and lack of economic transformation, but also effectively delivering public services to ensure the achievement of social objectives.

76. In order to achieve the Millennium Development Goals and other social development goals, African countries must find ways to translate economic growth

into meaningful job creation and social development. This can be done by implementing several broad actions. These actions should include efforts to mainstream social development objectives in national growth and development strategies with adequate budgetary allocations dedicated to achieving the Millennium Development Goals; promotion of an active private sector, with involvement of civil society and non-governmental organizations in efforts to achieve social development goals; and improvement of national capacity to monitor and report on the Millennium Development Goals and other social development goals, including strengthened national statistical systems. African countries must focus on the social development indicators that show where they are particularly lagging behind. First on this list should be eradication of extreme poverty.

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Summary of the Economic and Social Survey of Asia and the Pacific 2011

Summary

The economies of Asia and the Pacific recovered strongly in 2010 from the depths of the "great recession" of 2008/09, but they face fresh challenges in 2011. These include the return of food and fuel crises that are threatening hard-won development gains, sluggish recovery in the advanced economies and a deluge of short-term capital flows that in turn is leading to volatility in capital markets, the build-up of asset bubbles and the appreciation of exchange rates. Furthermore, the devastation wrought by the recent earthquake and tsunami in Japan provides another stark reminder of the region's vulnerability to natural disasters. These challenges pose significant downside risks to an otherwise robust growth outlook as the region emerges as a growth pole of the global economy.

In addition to addressing short-term risks, policymakers have to meet the challenge of rebalancing the region's economies in favour of domestic and regional investment and consumption. While wide development gaps provide significant headroom for expanding domestic demand, deepening regional economic cooperation is also critical to sustain dynamism in coming years. Some of the areas needing policy attention are enhancement of connectivity between markets and peoples through improved transport linkages, regional institution-building, streamlined transport and trade facilitation and progress towards a regional energy framework.

The region's least developed countries have not been able to enjoy the emerging opportunities offered by expanding markets and strengthened connectivity owing to their lack of productive capacity. Besides putting in place a supportive national policy framework, they need to be assisted in building productive capacities by their development partners.

* E/2011/100.

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The *Economic and Social Survey of Asia and the Pacific 2011* assesses the critical issues, policy challenges and risks that the region faces in coming months and outlines the elements of a policy agenda for sustaining dynamism and inclusive development for an Asia-Pacific century.

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I. Introduction

1. The Asia-Pacific region has recovered strongly from the 2008/09 recession but it is not out of the woods yet. The global environment in 2011 is turning out to be more difficult than that of 2010 since it will require dealing with a multiplicity of concurrent challenges. As demand from the developed world continues to remain sluggish, the region is being assailed by a resurgence in food and energy prices, with the repercussions of a host of natural disasters in the region having further impacts on both economic growth and prices. Nevertheless, the divergence in overall growth prospects for the region in the coming years as compared with the developed world suggests a central role for the Asian and Pacific region not only in driving its own development but also in being a critical anchor for the global recovery from the recession.

2. The recovery of the region has come under pressure in recent months due to dramatic increases in global food and energy prices as well as to the resumption of robust growth. This has disproportionately hurt the region's poorest and most vulnerable people and most directly impacted their livelihoods. The developing economies will also be affected by high energy prices that will increase input costs for industry, which in this region tends to be energy intensive.

3. Another key short-term challenge for the region, stemming from the recovery measures of developed countries to stimulate their economies, is the impact of the enormous liquidity injections undertaken by those countries to revive their economies. Favourable growth prospects and comparatively high interest rates in developing economies have attracted large foreign portfolio inflows from international investors to asset markets in the region. These capital inflows have led to inflationary pressures and the formation of asset market bubbles, besides exchange rate appreciation in some countries.

4. These short-term threats have been exacerbated by a host of natural disasters. The catastrophic earthquakes and tsunami that struck Japan from March 2011 have affected not only the country itself but also the wider region, owing to Japan's key role in the interconnected Asia-Pacific economy. Other major disasters have included floods in Pakistan and an earthquake in New Zealand. Food-producing economies such as Australia, China, India and Kazakhstan have in addition been affected both by drought and excess rainfall, reducing food supplies and helping push up prices. Indeed, the Asia-Pacific region as a whole seems to have suffered more from such disasters than other global regions.[1] Countries will therefore need to integrate the risk of such disasters into regional economic and social policymaking and to take measures to mitigate the effects.

5. The major medium-term challenge for the region continues to be the slow pace of recovery of the developed world and its unlikely role in being as significant a growth driver for the region as it was before the crisis. The continuing export dependence on developed country markets of many small economies in the region will mean that growth rates in the region will be impacted. Conversely, an

[1] Economic and Social Commission for Asia and the Pacific and the United Nations International Strategy for Disaster Reduction, *Asia Pacific Disaster Report 2010: Protecting Development Gains: Reducing Disaster Vulnerability and Building Resilience in Asia and the Pacific* (Bangkok, 2010). Available from www.unescap.org/idd/pubs/Asia-Pacific-Disaster-Report-2010.pdf.

increasing trend of intraregional trade, with markets characterized by large domestic demand in the region, should provide some replacement for exports to developed country markets.

6. The present report summarizes the key findings of the *Economic and Social Survey of Asia and the Pacific 2011*. It also outlines a policy agenda covering the main challenges in 2011 and over the medium term, and indicates ways of enhancing regional integration through greater connectivity. In addition, the *Survey* suggests how to increase the productive capacity of the least developed countries.

II. Coping with sluggish growth in developed countries

7. In 2010, the region witnessed a dramatic "V-shaped" recovery in growth. In fact, growth started to gain momentum from the first quarter of 2009, although many export-oriented economies only moved into positive territory around the third quarter. For the economies most affected, following the initial critical support to growth through massive fiscal stimulus packages, the key driver of private-sector recovery was renewed strength in exports. Exporting economies began their recoveries in part through intraregional sales to the large robust economies in Asia and the Pacific and eventually to the developed economies that saw improved demand beginning in late 2009.

8. After an initial strong recovery, the United States of America and the European Union are suffering from sluggish growth, which was partly responsible for the region's falling monthly export growth numbers in recent months.

9. The recent earthquakes and tsunami in Japan will also have repercussions across the region. However, the effects might be limited. The Economic and Social Commission for Asia and the Pacific (ESCAP) estimates that a 1.0 percentage point slowdown in Japan relative to 2011 baseline growth would result in a 0.1 percentage point slowdown for Asian and Pacific developing economies as a whole. The economies most affected would be Singapore (0.24 percentage points), Indonesia (0.16 percentage points) and Malaysia and Thailand (0.13 percentage points).

Managing the repercussions from the European debt crisis

10. The economies in the Asia-Pacific region should prepare for possible spillovers from the public debt crisis in European economies.[2] In recent months, the bailouts of Greece, Ireland and Portugal, as well as concerns about Spain, have led to credit downgrades that have increased the costs of debt servicing. But global financial markets have yet to be convinced, and sovereign debt defaults remain a concern.

11. The risk for Governments of countries in Asia and the Pacific lies in the possibility that any resulting financial contagion would spark off another seizure in global interbank lending. While the banking sector in most of the region is healthy

[2] For further details, see Economic and Social Commission for Asia and the Pacific, "The European debt crisis: implications for Asia and the Pacific", *MPDD Policy Brief*, No. 4 (August 2010). Available from http://www.unescap.org/pdd/publications/me_brief/mpdd-pb-4.pdf.

at the domestic level, in some economies it is exposed to global shocks due to dependence on borrowing from abroad.

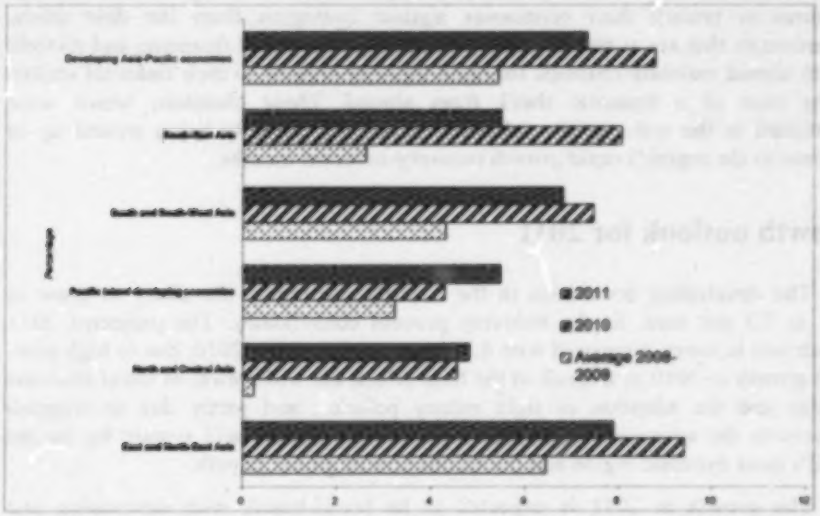
12. In such a climate of uncertainty, policymakers in the region should adopt measures to protect their economies against contagion from the debt crisis. Governments that are at risk of sharp withdrawals of external financing and a credit crunch should maintain channels for rapid liquidity support to their financial sectors in the case of a financial shock from abroad. These channels, which were established in the wake of the subprime crisis, are currently being wound up in response to the region's rapid growth recovery in recent months.

III. Growth outlook for 2011

13. The developing economies in the Asia-Pacific region are likely to grow in 2011 at 7.3 per cent, as the recovery process consolidates. The projected 2011 growth rate is lower, compared with 8.8 per cent achieved in 2010, due to high post-crisis growth in 2010 as a result of the base effect, the withdrawal of fiscal stimulus policies and the adoption of tight money policies, and partly due to sluggish recovery in the advanced economies. Asia and the Pacific will remain by far the world's most dynamic region and the locomotive of global growth.

14. The growth in 2011 is expected to be broad-based, with developing and transition economies in East and North-East Asia growing at 7.9 per cent, in North and Central Asia at 4.8 per cent, in Pacific island developing economies at 5.5 per cent, in South and South-West Asia at 6.8 per cent and in South-East Asia at 5.5 per cent (see figure I).

Figure I
Economic growth rates of developing economies in the Asia-Pacific region, 2008-2011



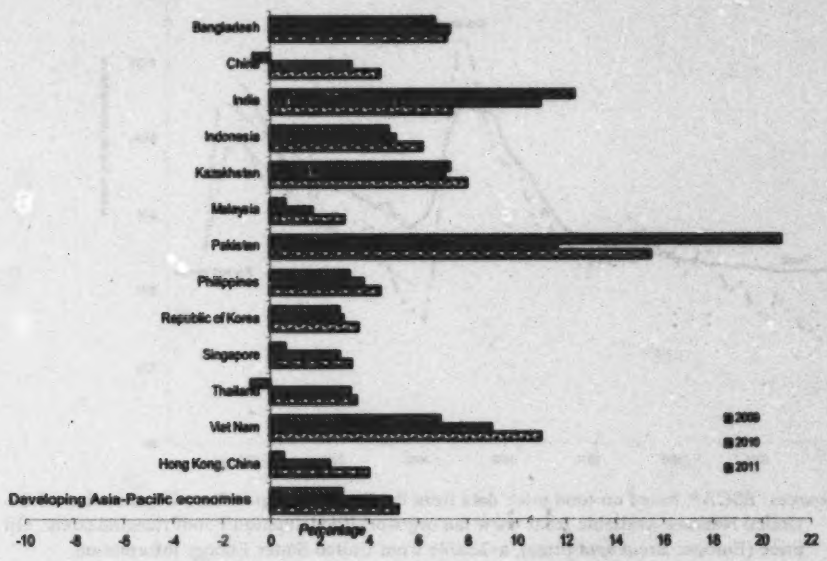
Sources: ESCAP calculations based on national sources; International Monetary Fund, *International Financial statistics database* (Washington, D.C., March 2011); Asia Development Bank, *Key Indicators for Asia and the Pacific 2010* (Manila, 2010); and ESCAP estimates.

Notes: Gross domestic product (GDP) growth for 2010 and 2011 are estimates and forecasts, respectively.

15. Large developing economies in the region should continue to grow strongly. The fastest-growing major economies in 2011 are expected to be China and India, with a forecast growth of 9.5 per cent and 8.7 per cent, respectively, followed by Indonesia at 6.5 per cent. India and Indonesia will benefit from robust consumption and investment, and China should respond to Government measures to move towards a more consumption-driven economy.

16. In 2011, most economies are likely to see an increase in inflation (figure II). To some extent, the inflationary pressures reflect a resumption in growth. However, inflation will also result from rising food and energy prices, which have a particularly damaging impact on the poor and vulnerable. Furthermore, there are significant risks resulting from capital inflows caused by excess global liquidity. In response, several economies have tightened monetary policy, adding to pressure on growth.

Figure II
Consumer price inflation[a] of selected developing economies, ESCAP region, 2009-2011



Sources: ESCAP, based on figure I above.

Notes: Rates of inflation for 2010 are estimates and those for 2011 are forecasts (as at 2 March 2011). Developing economies of the region comprise 37 economies (excluding the Central Asian countries), and the calculations are based on the weighted average of gross domestic product figures in 2009 United States dollars (at 2000 prices).

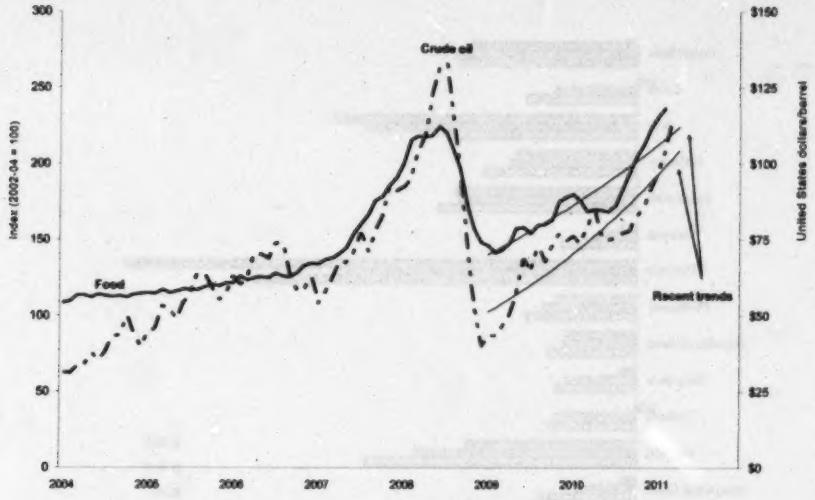
[a] Changes in the consumer price index.

IV. Key challenges to the outlook: protecting growth from external pressures

A. Return of food and fuel crises: impacts on income and poverty

17. Rising food and energy prices are emerging as an issue of serious concern across much of the region in a manner reminiscent of the 2007-2008 period just before the onset of the financial crisis. Since 2010, global food and oil prices have been on a sustained and synchronized upward trend. The food price index of the Food and Agriculture Organization of the United Nations (FAO) in December 2010 exceeded its previous record value that had been recorded in 2008 (see figure III). Since crossing that record level, the index continued to set new records in a number of subsequent months, with increasingly dire impacts on the livelihoods of the poor and contributing to social upheaval across the globe. Since 2010, oil prices have also been rising rapidly, with increased global demand due to growth recovery in emerging markets coupled with a number of supply shocks, particularly due to geo-political instability in the Middle East.

Figure III
Food price index and crude oil price, 2004-2011



Sources: ESCAP, based on food price data from the Food and Agriculture Organization of the United Nations, available from www.fao.org/worldfoodsituation/FoodPricesIndex/en/. Oil price (Europe: Brent spot price), available from United States Energy Information Administration, www.eia.doe.gov/dnav/pet/pet_pri_spt_s1_d.htm.

18. ESCAP estimates that there is a risk that high energy price increases can reduce growth by up to 1 percentage point in some developing Asia-Pacific economies as well as put pressure on inflation and adversely affect current accounts (see table 1). High oil prices will increase costs for domestic industry, while also pushing up the price of imports and reducing demand for exports. In addition, businesses will be affected by the slowdown in exports to developed economies due to constrained consumption in these economies related to higher energy costs.

Table 1
Summary of oil price impacts on macroeconomic variables for developing countries in the Asia-Pacific region

	$10 oil price increase			*$25 oil price increase*		
Countries	*Output growth*	*Inflation*	*Current account to GDP ratio*	*Output growth*	*Inflation*	*Current account to GDP ratio*
China	-0.13	0.28	-0.17	-0.36	0.77	-0.49
India	-0.23	0.52	-0.16	-0.64	1.46	-0.47
Indonesia	-0.18	0.26	-0.06	-0.49	0.73	-0.15
Malaysia	-0.16	0.33	0.23	-0.44	0.92	0.68
Philippines	-0.27	0.39	-0.14	-0.75	1.09	-0.39

Countries	$10 oil price increase			$25 oil price increase		
	Output growth	Inflation	Current account to GDP ratio	Output growth	Inflation	Current account to GDP ratio
Republic of Korea	-0.23	0.34	-0.16	-0.64	1.46	-0.47
Singapore	-0.33	0.26	-0.24	-0.91	0.74	-0.68
Thailand	-0.22	0.19	-0.37	-0.62	0.94	-1.06
Developing Asia-Pacific countries	-0.17	0.31	-0.25	-0.47	0.87	-0.73

Source: ESCAP computations in the framework of the Oxford Economic Forecasting model.
Notes: Under the baseline assumption of the Brent crude oil price being $105 per barrel; impacts are shown in absolute percentage differences from the baseline scenario.

19. Of even greater direct impact on the poor and vulnerable would be rising food prices. Since 2009, general food prices have increased in various countries by as much as 35 per cent. ESCAP estimates that an additional 19.4 million people in the region are living in poverty due to increased food prices in 2010. ESCAP has also estimated the impact on poverty of a number of possible food and energy price scenarios in 2011 (see table 2). Under the most pessimistic scenario in which there are further increases in food inflation and oil prices, with staple food prices in 2011 rising above the consumer price index inflation at twice the 2010 rate and the average oil price reaching $130 per barrel, an additional 42.4 million people could remain in poverty. This would result in a loss of up to five years in the efforts of many countries to achieve Goal 1 of the Millennium Development Goals, on eradicating extreme poverty and hunger, including the least developed countries, such as Bangladesh, the Lao People's Democratic Republic and Nepal.

Table 2
Effect of different staple food price scenarios (millions)

	Scenario 1			Scenario 2			Scenario 3		
	Staple food inflation in 2011, at half the 2010 rate and $105 oil price			Staple food inflation in 2011, at same rate as in 2010 and $115 oil price			Staple food inflation in 2011, at twice the 2010 rate and $130 oil price		
	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total
Pushed into poverty	0.1	1.3	1.5	1.5	3.7	5.1	3.9	13.9	17.8
Prevented from getting out of poverty	1.9	6.5	8.3	2.6	12.5	15.1	3.6	21.0	24.6
Total	**2.0**	**7.8**	**9.8**	**4.1**	**16.2**	**20.2**	**7.6**	**34.8**	**42.4**

Source: ESCAP secretariat based on data from the global information and early warning system website and the World Bank global income distribution dynamics data set.
Notes: Values may not sum to total due to rounding.

B. Addressing the challenge of rising food prices

20. Depending on the degree of impact of food price inflation on other product prices, and on related wage demands, Governments are likely to respond with monetary policy. However, they will also need to address the supply-side causes of food price increases and reduce the impact of such increases on the poor and vulnerable sections of society.

21. Measures to address the causes of food price increases should include, first, international cooperation and regulation to curb financial speculation in commodity prices. If such regulation is confined to the United States or the European Union, this could simply deflect trading to other jurisdictions. The effort therefore needs to be global through forums such as the United Nations or the Group of Twenty.

22. Second, price volatility of food grains should be addressed through the countercyclical use of buffer stocks. Third, vulnerable sections of the population should be protected through public food distribution systems, and social protection should be strengthened through food vouchers or targeted income transfer schemes,[3] besides reducing prices through lowering tariffs and taxes. Midday meals schemes, already in use in many schools, can also protect the nutritional security of children.

23. Finally, in the medium term, efforts should be made to deliver a supply response by reversing the neglect of agriculture in public policy through enhancing support for agricultural research, development and extension and by providing easier access to credit and other inputs in order to foster a new, knowledge-intensive "green revolution" that would make agriculture more environmentally resilient.[4]

24. At the regional level, price shocks can be managed cooperatively by establishing regional food stocks such as the rice reserve initiative of the Association of Southeast Asian Nations (ASEAN+3) and the South Asian Association for Regional Cooperation (SAARC) Food Bank. Agricultural productivity can also benefit from South-South and triangular cooperation on knowledge and technology transfer.

C. Managing capital inflows

25. As a result of accommodative monetary policies and low interest rates in developed economies, investors are turning their attention instead to developing economies. Other than reallocation of existing funds by financial institutions, there is once again the burgeoning "carry trade", using borrowings in foreign currencies to invest in higher-yielding currencies in both the developed and developing countries.

26. Such investments include currency deposits in local banks, portfolio investment in the bond and equity markets and corporate bond and equity issues, as well as lending to domestic banks and local subsidiaries. Equity markets in the Republic of Korea, the Philippines and Thailand, for example, are already at their pre-crisis peaks. Many investors have also turned to property, both in emerging

[3] For further details, see *Sustainable Agriculture and Food Security in Asia and the Pacific* (United Nations publication, Sales No. E.09.II.F.12).

[4] For further details, see *Economic and Social Survey of Asia and the Pacific 2010* (United Nations publication, Sales No. E.10.II.F.2).

economies such as China as well as in high-income economies such as Hong Kong, China and Singapore. As result, the Asia-Pacific region has seen some of the world's steepest increases in property prices.

27. Many economies in the region have current account surpluses that would put upward pressure on exchange rates. But capital inflows have introduced additional appreciation pressures, including for economies running current account deficits, such as India. Most major currencies in the region have risen significantly since 2009. Stronger currencies make it even more difficult to address the challenges of a current account deficit for macroeconomic stability. [5]

28. Economies have attempted to insure themselves against the risk of sudden capital outflows by building up foreign exchange reserves. But these may be inadequate. A vulnerability yardstick developed by ESCAP indicates that the reserves of a number of countries are substantially exceeded by their overall gross external liabilities.[6] Apart from not being a guaranteed insurance policy, building up reserves is also costly and a second-best solution for managing capital inflows.

29. Capital controls should be seen as important elements of the policy tool kit for reducing the volatility of the capital flows, as has been recommended by ESCAP previously.[6] Some economies in the region have imposed capital controls over the past year, an approach which is now supported even by the International Monetary Fund.[7] Developed economies should also support the imposition of such controls while also taking measures of their own, for example, by taxing capital outflows as well as by imposing high-margin requirements on foreign exchange derivatives that mimic actual outflows.[8]

D. Unemployment remains a concern for the vulnerable

30. Growth in the region has supported a recovery in many labour markets but there are still acute concerns about the quality of jobs and the vulnerability of workers. The region's more developed economies where labour markets have not returned to pre-crisis levels will also need policies that foster job-rich growth. Nevertheless, in most countries unemployment was lower in 2010 than in 2009.

31. The most serious problems are for youth, who are 3.2 times more likely than adults to be unemployed. In South-East Asia and the Pacific, that ratio rises to 4.7, the highest among the world's subregions. Across the region, some 1.1 billion workers remain in vulnerable employment. For instance, 47 per cent of workers are living with their families on less than $2 a day, and 23 per cent of workers are living in extreme deprivation on less than $1.25 a day.

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[5] See Yilmaz Akyuz, "Capital flows to developing countries in a historical perspective: will the current boom end in a bust?", South Centre Research Paper, 37 (2011). Available from www.southcentre.org/index.php?option=com_docman&task=doc_download&gid=1974&Itemid=182&lang=es.

[6] For more details, see *Economic and Social Survey of Asia and the Pacific 2010*, pp. 21 and 22.

[7] International Monetary Fund, "IMF develops framework to manage capital inflows", *IMF Survey*, 5 April 2011. Available from http://ftalphaville.ft.com/blog/2011/03/28/529131/more-on-uncertainty-and-capital-controls/.

[8] See, for example, Stephany Griffith-Jones and Kevin P. Gallagher, "Curbing hot capital flows to protect the real economy", *Economic and Political Weekly* (January 2011), pp. 12-14. Available from http://ase.tufts.edu/gdae/Pubs/rp/Griffith-Jones_GallagherEPWJan11.pdf.

32. As labour markets in the Asia-Pacific region recover and policymakers seek to rebalance their economies, they will need to focus more on quality jobs and incomes. A post-crisis macroeconomic framework should aim at full employment, for men and women, as a core policy goal, in addition to addressing economic growth targets, inflation and sustainable public finances. As countries in the region reconsider their fiscal policies, and their sustainability, it is critical to incorporate a basic social floor. In addition to reducing insecurity for the poor, improved social protection can support countries in their efforts to rebalance the sources of growth. The crisis has prompted some countries in the region, including Malaysia and the Philippines, to consider establishing unemployment insurance schemes, while India has expanded its national rural employment guarantee scheme.

E. Support alternative sources of demand

33. In the medium term, the fundamental challenge for the economies in the Asia-Pacific region will be to substitute in some measure the demand from developed economies with local demand.[9] This will not only sustain growth but will also help to reduce global imbalances. At the national level, reducing the dependence on consumption from the developed world will mean both increasing domestic demand in the major economies and boosting intraregional trade. In East Asia and, most importantly, in China, the main shortfall is in consumption, while in South-East Asia, it is in investment.

34. Boosting domestic consumption should mean increasing the consumption rates of the poor and also offering social protection programmes that will enable them to reduce precautionary savings for health and education needs. In the case of investment, funds should be directed to narrowing development gaps, most notably in infrastructure. As well as using domestic resources for investment, countries should also be able to benefit from the region's considerable foreign exchange reserves, through the establishment of a regional infrastructure financing mechanism. A recent study has estimated the infrastructure needs of the Asia-Pacific region for 2011-2020 at around $8 trillion ($5.4 trillion for new capacity and $2.6 trillion for replacement of old infrastructure), or $800 billion per year.[10] In that context, a regional financial architecture could serve as an intermediary between the region's $5 trillion of foreign exchange reserves and its unmet infrastructure needs. One option would be an infrastructure development fund managed by a regional institution. If this utilized just 5 per cent of the region's reserves, it would have a start-up capital of $250 billion, besides the ability to borrow from central banks. The region would also need to catalyse private investments, for example, through public-private partnerships. Economies in the Asia-Pacific region also have the opportunity to develop new greener industries, saving energy and materials and providing more affordable products to the poor while maintaining growth and enhancing the environmental sustainability.

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[9] For a full discussion of the issues summarized in this section, see *Economic and Social Survey of Asia and the Pacific 2010* (United Nations publication, Sales No. E.10.II.F.2), chap. 3.

[10] Asian Development Bank and Asian Development Bank Institute, *Infrastructure for a Seamless Asia* (Tokyo, Asian Development Bank Institute, 2009). Available from http://www.adbi.org/book/2009/09/15/3322.infrastructure.seamless.asia/.

F. Development-friendly global economic governance

35. The Group of Twenty has adopted a framework for strong, sustainable and balanced growth.[11] The Asia-Pacific region could significantly contribute to this by boosting aggregate global demand, while also addressing the region's most urgent development needs. The Asia-Pacific region has eight members of the Group of Twenty who could coordinate their positions to ensure that a new international financial architecture meets the region's development needs. The Group of Twenty can further enhance its credibility and effectiveness by evolving mechanisms for consultation with the non-member countries, as was arranged by ESCAP prior to the summit held in Seoul. Important proposals include establishing a special-drawing-rights-based global reserve currency that could be issued countercyclically; a global tax on financial transactions to raise resources for achieving the Millennium Development Goals, besides moderating short-term capital flows; and international regulations to curb excessive risk-taking by the financial sector. The Group of Twenty should also take measures to moderate the volatility of food and oil prices that are highly disruptive in the process of development. In the case of food price volatility, the Group of Twenty may act to regulate the speculative activity in food commodities and discipline the conversion of cereals into biofuels. It may expedite the implementation of the L'Aquila Food Security Initiative, which included provision of financing to developing countries for food security. In the area of oil price volatility the Group of Twenty, representing the major oil consumers, could demarcate a benchmark "fair" price for oil with oil-producing countries and obtain agreement to restrict oil price movement within a band around it. An additional measure to moderate the volatility in the oil markets is for the Group of Twenty to create a global strategic reserve and release it countercyclically. In these and other areas, the Asia-Pacific region can further integrate and coordinate its actions.

V. Connectivity to boost regional integration

36. Regional demand can be boosted through greater economic integration, driven by populous and rapidly growing economies such as China and India whose dynamic domestic markets can also benefit their smaller and poorer neighbours. But this cannot be taken for granted. The rising tide of development opportunities will not lift all boats if these are separated by water locks. These obstructions can take the form, for example, of restrictive non-tariff measures, complicated and time-consuming customs procedures, differences in regulations and poor transport infrastructure. As a result, the enormous opportunities generated by the more dynamic centres may stop at their national borders.

Intraregional trade

37. Intraregional trade among countries in the Asia-Pacific region has expanded at a faster pace than their global trade, bringing its share to nearly 52 per cent in 2008. The analysis contained in the *Survey* shows that the potential of intraregional trade remains to be fully exploited partly due to high trade costs, which include not only

[11] See leaders' statement, the Pittsburgh Summit, 24 and 25 September 2009. Available from www.pittsburghsummit.gov/mediacenter/129639.htm.

import tariffs but also onerous customs procedures and restrictions on the movement of vehicles and trains across borders.

38. The potential for greater trade is evident from the extent of complementarities between and within Asia-Pacific subregions, in particular between East and North-East Asia and South-East Asia and within East and North-East Asia. Interestingly, for four of the five subregions trade complementarities were greater with other subregions than within the subregions themselves. Regional integration should focus therefore not just on deepening integration within subregions but also on fostering trade links across subregions.

Intraregional foreign direct investment

39. In the past, most foreign direct investment inflows to countries in the Asia-Pacific region came from developed countries, but nowadays an increasingly larger proportion comes from developing countries. In recent years China, India, Malaysia, the Russian Federation and Singapore have become important sources of foreign direct investment. Transnational corporations from these and other developing countries in the region tend to invest in neighbouring countries that have similar economic conditions and institutions — contributing much-needed investment and technological expertise that can enhance the productive capabilities of lower-income countries. As a result, many low-income countries in Asia and the Pacific now get most of their foreign direct investment from other developing countries in the region.

Preferential trading arrangements

40. The countries in the Asia-Pacific region have been very active in pursuing preferential trading arrangements in recent years and as at the end of 2010 were party to 170 of them. Because of their bilateral and subregional nature, these agreements are not contributing to create a seamless, broader and unified Asian and Pacific market. Two important initiatives in that direction are the East Asia Free Trade Agreement and the Comprehensive Economic Partnership of East Asia.

41. In particular, the Comprehensive Economic Partnership of East Asia, covering about 80 per cent of the region's population and gross domestic product, could constitute the nucleus for an incipient wide free trade area in Asia and the Pacific, to which other countries in the region could accede. A complementary option would be a regional framework to link various subregional groupings in a preferential arrangement. As a broader regional forum with convening power, ESCAP could facilitate emergence of such broader arrangements in the region. Considering the diverse levels of development in the region, the regional trading arrangements should not only include special and differential treatment provisions but also incorporate economic cooperation to narrow the development gaps.

Transport links

42. Export growth has resulted in a rapid expansion of maritime shipping. As of 2009, Asia had the world's top five container ports — Singapore, Shanghai, Hong Kong, China, Shenzhen and Busan — which accounted for 23 per cent of the world's total container ports. As a result, much economic development has been concentrated around major maritime ports, where many Governments have opened special economic zones or export processing zones. Meanwhile, large hinterland

areas have remained relatively underdeveloped. Moving goods to the hinterlands of some countries and across countries is still expensive, as a result of long distances, high operating costs for trucks due to poor roads and aging vehicles, high trans-shipment costs and complex border crossing procedures. In addition, the Pacific island developing economies face high costs because of low volumes.

43. The Intergovernmental Agreement on the Asian Highway Network[12] and the Intergovernmental Agreement on the Trans-Asian Railway Network,[13] which were signed under ESCAP auspices, have contributed to infrastructure investment and also triggered several multilateral initiatives. For instance, the Asian Development Bank, in collaboration with ESCAP, has recently initiated a project on the development of priority Trans-Asian Railway routes and Trans-Asian Railway lines. The main current challenge for transport connectivity is to improve linkages between modes, for example, between ports and roads and railways. It will also be important to extend routes to hinterland areas and through landlocked countries and transit countries as well as to small island developing States in the Pacific. To assist in the integration of networks, ESCAP is developing a third intergovernmental agreement focusing on international dry ports across the Trans-Asian Railway and Trans-Asian Railway networks.

Trade and transport facilitation

44. Many countries now realize the importance of streamlining trade procedures. For that purpose, they are relying more on electronic data interchange and aim to institute national electronic single windows through which traders can submit required documentation, pay duties and receive clearance. Although economies such as Singapore, the Republic of Korea and Hong Kong, China, are world leaders in that area, the full benefits of single windows cannot be realized until the electronic data and documents in a national single window can be accepted by authorities in partner countries. Often the problem is the lack of cooperation and coordination across national agencies within countries. While those issues are national, they also affect connectivity with neighbours and the rest of the region. One option for improving inter-agency cooperation and coordination is for Governments to designate single national lead agencies.

45. The overall efficiency of international transport will also depend on the harmonization of legal regimes. The Almaty Programme of Action[14] indicates that landlocked developing countries should consider international conventions, and regional and bilateral agreements, as the main vehicles for harmonization, simplification and standardization. However, progress under ESCAP resolution 48/11 of 23 April 1992, which recommended that countries in the ESCAP region accede to seven international conventions, has been uneven. The region's 12 landlocked countries have acceded, on average, to only four of the seven conventions, and only two countries, Kyrgyzstan and Uzbekistan, have acceded to all of them. Furthermore, some neighbouring transit countries of the region's

[12] United Nations, *Treaty Series*, vol. 2323, No. 41607.

[13] United Nations, *Treaty Series*, No. 46171.

[14] *Report of the International Ministerial Conference of Landlocked and Transit Developing Countries and Donor Countries and International Financial and Development Institutions on Transit Transport Cooperation, Almaty, Kazakhstan, 28 and 29 August 2003* (A/CONF.202/3), annex II.

landlocked countries have acceded to even fewer conventions, leading to a territorial discontinuity in their application which significantly reduces their effectiveness.

Information and communications technology connectivity

46. The most striking development in information and communications technology (ICT) connectivity has been the rapid diffusion of mobile networks and services. As a result, many poor people now have access to telecommunication services. In contrast, the region's developing countries have very low broadband penetration, well below 10 per cent. An important obstacle to better Internet services is the cost of deploying land-based or submarine fibre-optic cables. However, there has been some progress in the Pacific, where some least developed countries have benefited from linkages to existing cables.

47. In order to boost ICT connectivity, Governments will need policies at both national and regional levels. At the national level, it is important to set up regulatory frameworks that (a) promote the development of fair and competitive markets; (b) establish national standards which are compatible with international standards; and (c) encourage the development of innovative applications, such as mobile banking. For this purpose, it is advisable to establish independent regulators that can act in the best interests of both the State and end-users. At the regional level, it is important to take into account potential synergies between ICT infrastructure and other kinds of physical infrastructure.

Energy connectivity

48. Energy is a critical production input. As a result, disruptions in availability, or price increases, can have serious economic consequences. A fundamental goal is therefore energy security, understood as both a stable supply for importing countries and a stable demand for exporting countries. The Asia-Pacific region has both large energy-importing and large energy-exporting countries; energy security would therefore benefit from better physical connectivity between them as well as institutions to promote cooperation.

49. For connectivity, it may be useful to identify missing infrastructure links — considering investment needs from a region-wide perspective and taking into account projected increases in energy demand. In that respect, the Trans-Asian Railway and Trans-Asian Railway agreements could provide useful models. Other important issues to consider in the area of energy cooperation are pipeline security and safety and low-carbon paths that place more emphasis on efficiency and take greater advantage of renewable resources. Finally, it is important for the region to develop a deep, liquid and transparent market for crude oil, oil products and gas. Building blocks of such a market include identifying a crude oil price benchmark relevant for the region; gathering support from key buyers and sellers to ensure adequate trading volumes; building adequate storage infrastructure and creating a conducive regulatory framework; and ensuring robust financial markets to support hedging and trading. In order to foster energy cooperation on a sustained basis in the region, it could be useful to establish a structured Asia-Pacific regional energy dialogue.

People-to-people connectivity

50. People-to-people connectivity could help promote better mutual understanding, enhanced trust and greater respect for diversity, thus contributing to a culture of peace. The Asia-Pacific region is a growing source and destination of migrants for higher education and overseas employment as well as for tourism. While the majority of Asia-Pacific migrant workers leave the region, a significant proportion move within the region. For creating a legal framework for migration, subregions such as North and Central Asia, South-East Asia and the Pacific have already moved ahead with multilateral agreements, while some countries have established bilateral memorandums of understanding that establish guidelines and procedures for employment protection and the return of workers.

Financial cooperation

51. The region already has a number of initiatives for financial cooperation. These include the Chiang Mai Initiative Multilateralization, the Asian Bond Fund and the Asian Bond Market Initiative. Most, however, are in their early stages and have limited scope and coverage. The region needs a more developed regional financial architecture that could not only help to manage financial crises but could also provide an adequate supply of development finance.

52. To strengthen crisis management, the region could build on its pioneering initiative for financial cooperation, the Chiang Mai Initiative Multilateralization. This would involve expanding its membership to cover important countries like Australia, India and the Russian Federation and also increase its pool of resources. A well-endowed, and truly regional, crisis response facility of this type could reduce pressure on Governments to build large foreign exchange reserves. At the same time, the region needs a way to use its large savings to meet its equally large needs for infrastructural investment. For that purpose, it will need to deepen its financial markets and integrate its capital markets. In addition, it could consider creating a regional infrastructure development fund to deploy a small part of the region's foreign exchange reserves for infrastructure financing.

53. Additional elements of a regional financial architecture include: (a) improving exchange rate coordination to facilitate trade and macroeconomic stability and discourage competitive devaluations; (b) achieving closer cooperation between central banks and financing institutions to facilitate region-wide information-sharing and capacity-building among the region's least developed countries; (c) expanding public-private partnerships for investment in infrastructure by building capacities among policymakers, especially in the design of legal and regulatory regimes and in project development and management; and (d) active participation in global discussions on the reform of the international financial architecture to ensure that it supports the region's developmental needs.

IV. Building the productive capacity of the least developed countries

54. If the least developed countries are to benefit from greater connectivity and regional integration, they will need to increase their productive capacity. In the past 40 years, however, the region's least developed countries have made little progress

on that front. Their share of global GDP is less than a tenth of their share of global population, their share of exports has been lower than 0.25 per cent, and their contribution to manufactured exports has been lower than 0.2 per cent (see table 3).

Table 3
Share of least developed Asia-Pacific countries in international production and trade (percentage)

Indicator	*1970*	*1980*	*1990*	*2000*	*2007*	*2008*	*2009*
Population	3.18	3.21	3.44	3.65	3.83	3.78	3.86
GDP	0.43	0.22	0.18	0.22	0.23	0.24	0.25
Manufacturing, value added	0.60	0.14	0.16	0.16	0.20	0.31	0.58
Merchandize exports	0.11	0.12	0.09	0.17	0.19	0.19	0.24
Manufactured exports	0.01	0.06	0.07	0.16	0.12	0.04	0.01
High-technology exports	..	..	0.00	0.00	0.01	0.00	..

Source: ESCAP secretariat, based on data from the World Bank.

55. A renewed focus on building the productive capacity of the least developed countries should bring production back to the core of the development agenda. This should not mean, however, simply producing more of the same goods and services; least developed countries also need to expand the range of goods produced. Historically, it has been evident that as economies grow, they produce and export a much wider range of products. Increasing output in the least developed countries will require similar diversification.

56. As economies diversify, they also tend to export products that are exported by fewer other countries. This will generally mean more exclusive manufactured goods as opposed to more common exports such as vegetable oils, fish, textiles, garments or mining products. The countries in the region with more diversified production and more exclusive product mixes are Australia, China, India and Japan. The least developed countries, on the contrary, have not diversified and continue to produce fairly standard goods. This is also the situation in all the Pacific island developing economies. To some extent, this is a result of their small market size, owing to which they face an inherent disadvantage in their process of diversification.

57. Countries wishing to diversify can anticipate competition since most other countries are aiming to move in a similar direction. Between 1984 and 2009, the average diversification of countries participating in international trade rose from 968 to 1,868 products. In addition, for the average country the number of countries exporting a similar product mix increased from 41 to 91.

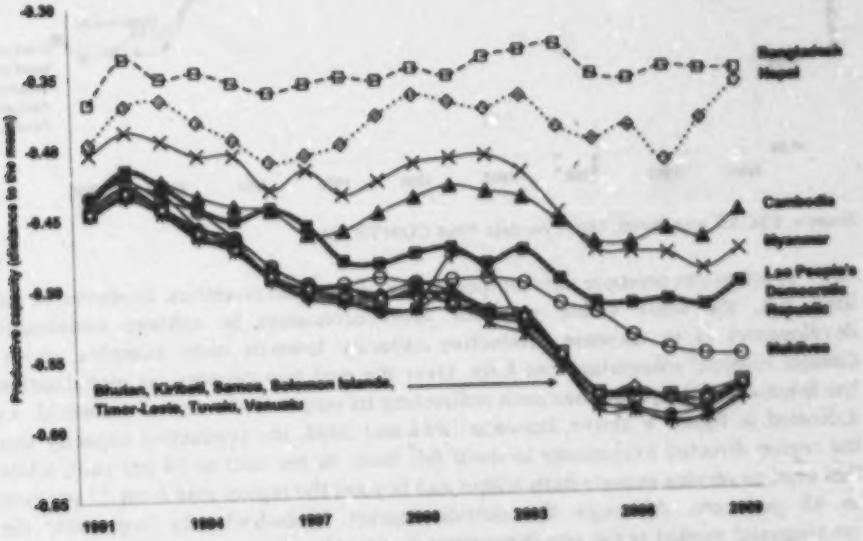
58. The process of diversification is path dependent: products that a country produces today affect those it will be able to produce tomorrow. As a result, diversifying towards some products would increase the range of possibilities for further diversification. Poorer countries need to choose the most appropriate new products for strategic diversification and the easiest will be those for which the required capabilities are similar to those already available.

59. In assessing the current level of productive capacity, it can be assumed that the fewest capabilities will be found in the countries that are the least diversified and

whose product mixes are similar to those of many other countries. This information on diversification can be combined with other measures to arrive at a composite "productive capacity index".

60. The results for least developed countries in Asia and the Pacific are indicated in figure IV, in which the level of productive capacity in each country is compared with the global mean over time. Bangladesh and Nepal have held their positions, while all the other countries, despite recent rises, have generally lost ground, not because they have reduced productive capacity but because they have progressed more slowly than others. This highlights the special circumstances that these countries face and the need for better targeted assistance and strategies for improving productive capacity.

Figure IV
Evolution of average productive capacity of least developed countries in the Asia-Pacific region, 1991-2009,

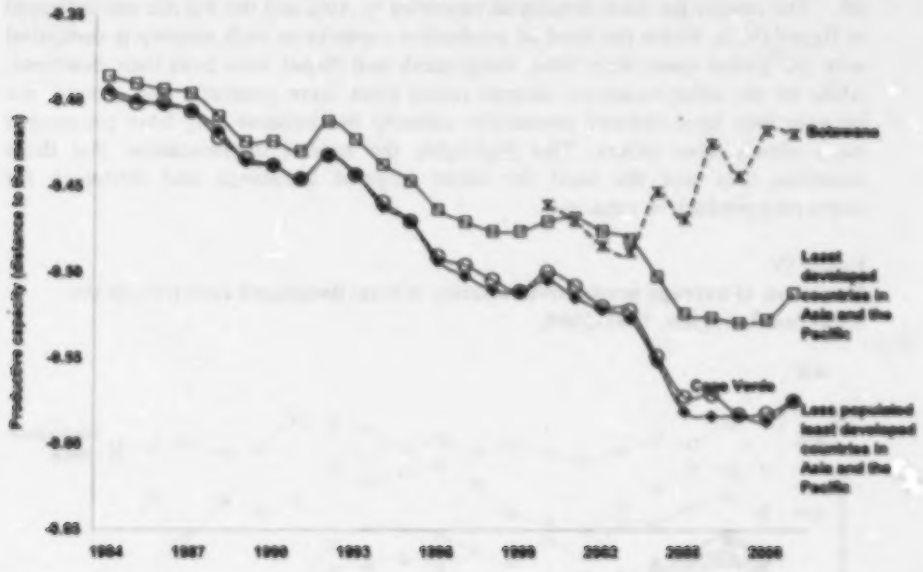


Source: ESCAP secretariat, based on data from COMTRADE.

61. It should be emphasized that small least developed countries can boost their per capita GDP, and thus their prospects for graduation from least developed country status, by exploiting and expanding tourism and other services.

62. Analysis suggests that, after controlling population size and the level of productive capacity, a 1.0 per cent increase in tourism revenue increases the total output of a country by around 0.25 per cent. The two least developed countries in Asia and the Pacific already recommended for graduation could follow a similar path. For Maldives, which graduated in January 2011, tourism makes up 50 per cent of GDP. For Samoa, which is set to graduate in 2014, tourism makes up 21 per cent of GDP.

Figure V
Evolution of productive capacity of least developed countries in the Asia-Pacific region and other graduating countries, 1984-2009



Source: ESCAP secretariat, based on data from COMTRADE.

63. Tourism can promote development in less populated countries. However, in the long run, the most viable way for most economies to achieve sustainable development is to increase productive capacity towards more complex goods. Greater regional integration can help. Over the past two decades, as globalization has intensified, the region has been redirecting its output to the rest of the world. As indicated in figure V above, between 1984 and 2008, the productive capacity that the region directed exclusively to itself fell from 40 per cent to 14 per cent, while that used to service exports both within and beyond the region rose from 22 per cent to 48 per cent. Although the outside market is undoubtedly important, the intraregional market is the one that generally provides the opportunities for moving to more complex products, serving as a training ground for exporting to the rest of the world. Hence, facilitating intraregional trade can also increase productive capacities.

64. Increasing productive capacities is not only a matter involving the more efficient exploitation of existing comparative advantage. It requires exploration of new economic activities and a more strategic approach towards building up capabilities to produce goods that are more exclusive and that are only produced by countries that are more diversified.

65. A pragmatic strategy for least developed countries to build their productive capacities is to let those capacities be generated or acquired as part of the process of such strategic diversification through the combined efforts of the State and the private sector, with a supportive role played by development partners. Such a strategy comprises three main processes, which, when set in motion, can act as an

algorithm for discovering, acquiring and spreading the productive capacities required for developing economies to catch up to more developed economies.

66. The first process is differentiation through strategic product innovation including the identification and production of products that are new to the firms or farms in the economy and that are more complex and facilitate further diversification. The second process is the selection of the business models of those firms and farms that were successful in the differentiation process. The third process is the amplification of the successful business models and the exploitation of the new market. It is important to the strategy that these processes be repeated continuously.

67. The experience of developed and newly industrialized countries has demonstrated the critical role played by strong and active intervention by the "development State" in the early stages. In what follows, a policy agenda for national action is outlined, as is a global partnership for implementing the strategy to increase the productive capacities of least developed countries, drawing upon the outcome of the High-level Asia-Pacific Policy Dialogue on the Brussels Programme of Action for the Least Developed Countries, organized by ESCAP in collaboration with the Government of Bangladesh in Dhaka in January 2010 (E/ESCAP/66/6).

National policy framework

Stable investment-friendly macroeconomic policy framework

68. Least developed countries need to maintain strong macroeconomic fundamentals. Countries need to utilize the full scope of appropriate countercyclical policies to maintain economic and financial stability in the face of shocks in order to avoid abrupt economic fluctuations.

Industrial policy and infrastructure development

69. Active public intervention is required to create infrastructure and promotional measures that are covered under industrial policy, including infant industry protection provided to a domestic industry in the early stages of development. Public investment could play a proactive role in infrastructure development and act as a catalyst of public-private partnerships by creating a virtuous cycle of investment and spurring inclusive growth.

Domestic resource mobilization

70. Least developed countries also need to foster a diversified, well-regulated and inclusive financial system that promotes savings and channels them to productive investments. The domestic supply of long-term capital also needs to be increased by developing domestic capital markets, venture capital funds and term-lending institutions, and industrial development banks in order to provide the finance required for the creation of new productive capacities.

Technological upgrading

71. The scientific, technological and research and development capacities of the least developed countries need to be built up through national programmes and supported by international institutions and programmes. Developed countries should, therefore, facilitate technology transfer to least developed countries as

required under article 66.2 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). It is also timely to consider setting up a technology bank for least developed countries, which could promote the transfer of key technologies, including pro-poor, green, agricultural and renewable energy-related technologies.

Supportive global partnerships for building productive capacities in least developed countries

Financing for development: foreign direct investment and official development assistance

72. The policies aimed at harnessing the potential of foreign direct investment should stimulate productive investment, build technological capacities, develop infrastructure and strengthen linkages within and across sectors and between different enterprises. Least developed countries could also adopt associated policies, such as performance requirements, to facilitate technology transfer and diffusion from foreign direct investment. Intraregional foreign direct investment originating in other developing countries, as observed earlier, enhances the options for them. Development partners could assist in investment promotion through leveraging official development assistance and by providing risk cover and capacity-building for project development, among other policies.

73. Efforts need to be made to continue to improve the quality of official development assistance and increase its development impact. There is a need to set up special purpose thematic funds dedicated to least developed countries, such as a commodity stabilization fund, a technology fund, a diversification fund and environment-related funds. Aid for "new" purposes needs to be truly additional and should not divert resources from other internationally agreed goals.

Market access and aid for trade

74. Least developed countries need to be provided with enhanced and predictable market access, support for the establishment of export supply capacity that is competitive both in cost and quality and new trade-related infrastructure. More transparent and simplified rules of origin and more comprehensive product coverage could improve the use and value of the Generalized System of Preferences. In addition, developed countries and developing countries in a position to do so should implement fully the duty-free, quota-free market access as agreed in the Hong Kong Ministerial Declaration.[15]

75. The focus of aid for trade should be to assist the least developed countries in building productive infrastructure and trade capacities in order to enable them to participate effectively in the multilateral trading system. Aid for trade should be aligned to national development strategies. In addition, least developed countries should receive priority attention for the disbursement of funds.

South-South, triangular and regional cooperation

76. With the rise of emerging countries in the region as the growth poles of the world economy, South-South, triangular and regional cooperation have become viable strategies for development. An increasing number of countries, including

[15] World Trade Organization, document WT/MIN(05)/DEC. Available from http://docsonline.wto.org.

China, India, Malaysia, the Russian Federation, Singapore and Thailand, have well-developed programmes for assisting other developing countries, especially the least developed countries, in their neighbourhoods. Such initiatives should be further promoted and extended.

77. The Asia-Pacific region emerged from the global financial crisis as a growth driver and anchor of stability of the global economy. It now has the historic opportunity to rebalance its economic structure in its favour in order to sustain dynamism with strengthened connectivity and balanced regional development and make the twenty-first century a truly Asia-Pacific century.

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Latin America and the Caribbean: economic situation and outlook, 2010-2011

Summary

Following the drop experienced in 2009, the gross domestic product (GDP) of Latin America and the Caribbean returned to growth in 2010, increasing by 6.1%. Although growth was observed essentially throughout the region, it reached 6.8% in South America and 4.9% in Mexico and Central America, but only increased by 0.5% in the English- and Dutch-speaking Caribbean. This growth was driven to a great extent by the countercyclical measures deployed by many countries, in addition to the recovery of the global economy that began in the first half of 2010. Greater economic growth had a positive impact on employment demand, pushing the regional unemployment rate down to 7.5%.

A number of external factors, such as fuel and food prices, pushed inflation up to 6.7% in 2010, although core inflation increased only slightly. The early months of 2011 saw a change in the situation, with some countries experiencing pressure on core inflation. A further impact of the higher prices for these commodities was that the exporting countries enjoyed better terms of trade and greater value of their exports. The scenario in the second half of 2010 was less optimistic, brought about by exhaustion of idle production capacity, public spending cuts and strong appreciation of the currencies of some countries of the region.

As a result, growth in 2011 is projected to reach 4.2%. The South American economies are expected to continue posting growth rates higher than the rest of the region, although lower than in 2010 because of the withdrawal of public policy efforts to spur demand, including tighter monetary policy to counter inflationary pressure and a slowdown in global growth.

* E/2011/100.

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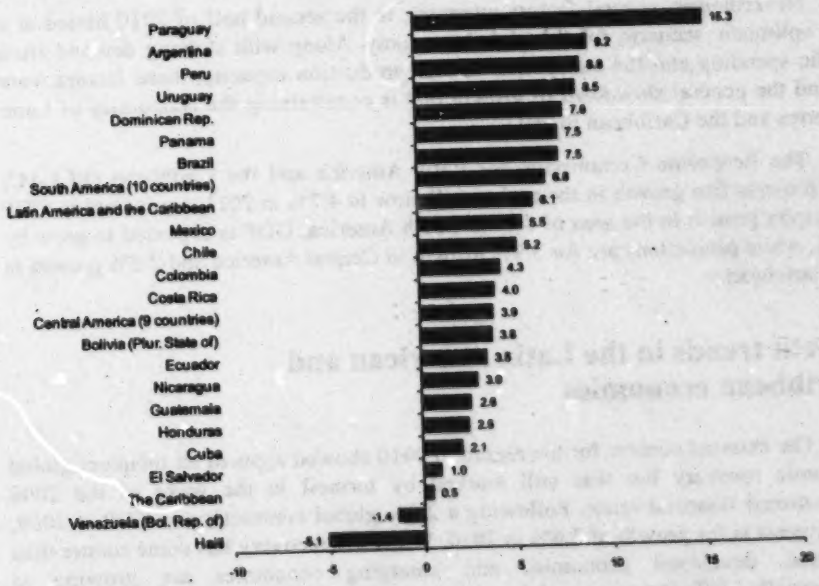
I. Introduction

1. Latin America and the Caribbean grew 6.1% in 2010, equivalent to 4.8% growth in per capita gross domestic product (GDP); this is the highest rate of growth since 2004. Although growth was observed essentially throughout the region, performance across subregions was uneven. While in South America GDP grew by 6.8%, in Central America it grew by 3.9%, in Mexico by 5.5% and in the English- and Dutch-speaking Caribbean by 0.5% (see figure I).

2. Growth in 2010 consolidated the recovery that had begun in most of the economies of the region in the second half of 2009, boosted by the countercyclical measures deployed by many countries. Unlike similar scenarios in the past, the expanded macroeconomic space in many countries of the region provided unprecedented scope for implementing policies geared towards weathering the crisis. Measures for counteracting the impact of the global crisis dovetailed with the rapid recovery of the global economy in the first half of 2010 to help sustain the improved performance of the economies of Latin America and the Caribbean.

Figure I
Latin America and the Caribbean: growth rates, 2010
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

3. Greater economic growth drove employment demand up (the region-wide unemployment rate is estimated to have fallen to approximately 7.5%) and helped to improve the quality of the jobs created. Rapid growth was accompanied by a slight uptick in inflation, which went from 4.7% in 2009 to an estimated 6.7% in 2010, owing above all to the behaviour of international prices for commodities such as

food and fuel. Although that uptick did not affect core inflation in 2010, the early months of 2011 did see a slight increase in this index.

4. This evolution of labour market indicators, plus expanding credit and the general improvement in expectations, helped to spur private consumption. These factors, along with a substantial rise in investment in machinery and equipment, were the main drivers of the rise in demand.

5. For the region as a whole, the favourable external scenario translated into higher export volume and value, although imports rose even more. The international context resulted in widely differing impacts according to each country's position in the market for goods and services.[1] The terms of trade for the countries that export commodities (agricultural products, minerals and hydrocarbons) improved, and the value of their exports climbed.

6. Most of the countries of Central America and the Caribbean, however, were hit again by the rising value of their imports, leading to net losses and further worsening their external balance. These negative impacts were offset in part by a certain degree of recovery in tourism and in remittances sent from developed countries by emigrant workers. Mexico benefited from a nascent recovery in the United States of America (Mexico's principal export market), which had experienced a severe crisis the year before.

7. Nevertheless, several factors emerging in the second half of 2010 hinted at a less optimistic scenario for the global economy. Along with slowing demand from public spending and the exhaustion of idle production capacity, these factors were behind the general slowdown of growth that is constraining the economies of Latin America and the Caribbean in 2011.

8. The Economic Commission for Latin America and the Caribbean (ECLAC) thus projects that growth in the region will slow to 4.2% in 2011, equivalent to GDP per capita growth in the area of 3%. In South America, GDP is expected to grow by 4.5%, while projections are for 3.9% growth in Central America and 2.2% growth in the Caribbean.

II. Recent trends in the Latin American and Caribbean economies

9. The external context for the region in 2010 showed signs of an incipient global economic recovery but was still marked by turmoil in the wake of the 2008 international financial crisis. Following a 2.0% global contraction of GDP in 2009, the forecast is for growth of 3.6% in 2010. While the recovery has come sooner than expected, developed economies and emerging economies are growing at substantially different rates, giving rise to some uncertainty as to the future sustainability of growth.

10. In such a scenario, some countries of Latin America could still benefit from growing demand for commodities and rising nominal prices owing to global depreciation of the dollar and the resulting appreciation of their own currencies;

[1] Commodity prices also reflected events in international financial markets, in particular the performance of the United States dollar and increased global liquidity.

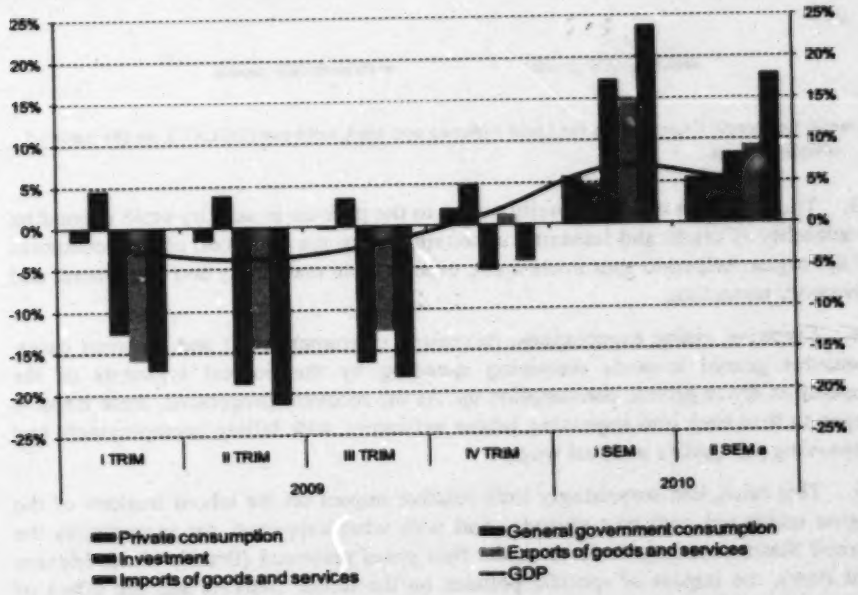
those factors would impact positively on terms of trade and on control of inflation through the import component. Nevertheless, these countries run the risk of discouraging other exports as it becomes harder for the region's tradable sectors to compete in external and domestic markets. This issue will be further discussed below.

A. Internal factors

11. The strong countercyclical measures deployed by the governments of most of the countries of the region enabled economic activity to recover quickly and, in most cases, to top pre-crisis levels. These factors were reflected in the evolution of the macroeconomic aggregates, with public consumption at the forefront of aggregate demand, especially in the first half of 2009 as can be seen in figure II.

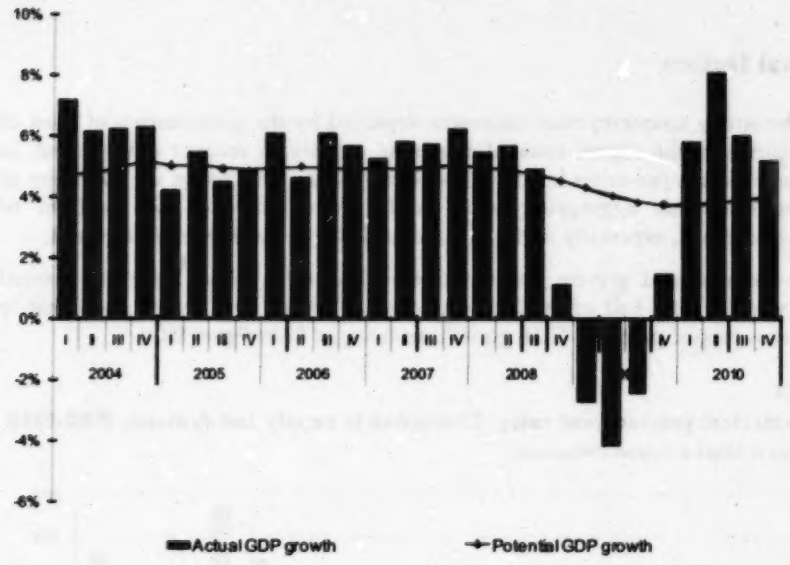
12. Investment and private consumption picked up by late 2009 and gained intensity in the first half of 2010. Rising demand led to high growth rates that in many cases topped potential GDP growth, as emerges from figure III.

Figure II
Latin America: year-on-year rates of variation in supply and demand, 2009-2010
(Percentages in dollars at constant 2000 prices)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Figure III
Latin America (nine countries): actual and potential GDP growth, year-on-year quarterly rates of variation, 2004-2010
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

13. The depletion of idle capacity owing to the pick-up in activity amid expanding availability of credit and lessening uncertainty as to the evolution of the economies of the region helped to spur investment, especially in machinery and equipment, and inventory restocking.

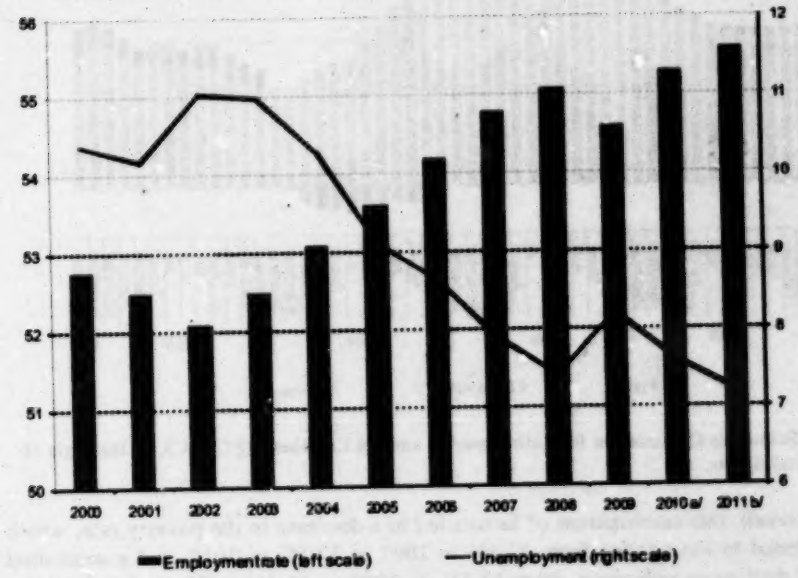
14. Likewise, rising expectations, increasing consumer credit and, in some cases, measures geared towards sustaining spending by the poorest segments of the population drove private consumption up. As the recovery progressed, these impacts began to feed back into improving labour indicators, with falling unemployment and improving job quality and real wages.

15. This crisis had surprisingly little relative impact on the labour markets of the region compared with past episodes and with what happened, for example, in the United States economy. Indeed, in the four cases reviewed (Brazil, Chile, Mexico and Peru), the impact of specific policies on the labour markets and the effect of monetary and fiscal policies on employment demand not only dampened the initial impact but also allowed a rapid recovery (Mexico might be an exception).

16. Job creation during the economic recovery brought the unemployment rate down from 8.2% to 7.5% despite the significant rise in labour participation (see figure IV). Most job creation took place in the formal sector; the resulting improvement in employment quality in many countries contributed to a quantitative improvement in labour market indicators. In addition, as the employment rate rose

more among women than among men, the strong increase in the female labour supply did not trigger greater unemployment among women. In fact, unemployment at the regional level dropped by similar proportions for men and women, although in the countries experiencing higher unemployment in 2010 (Bolivarian Republic of Venezuela, Honduras and Jamaica) the increase was greater among women than among men.

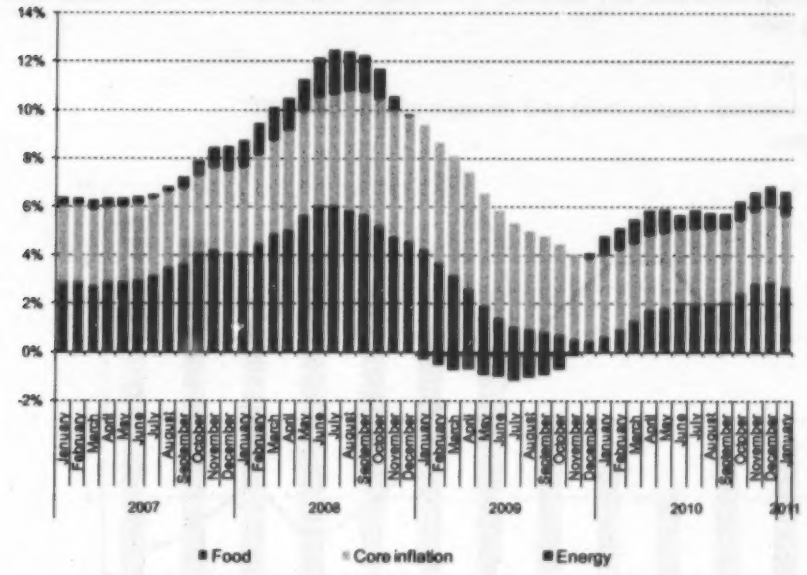
Figure IV
Latin America: employment and unemployment, 2000-2011
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Estimate.
[b] Projection.

17. Falling unemployment and improving employment quality were accompanied by an increase in real wages that was somewhat smaller than in 2009 (although greater than the annual increases during the rest of the decade), owing to a jump in inflation — from 4.7% to 6.7% — and greater enforcement of minimum wage policies. The main factor behind the higher inflation rate was the increase in food prices and, to a lesser extent, fuel prices, although, as can be seen in figure V, these rises did not transfer to core inflation (although the initial months of 2011 did see an increase in core inflation). The current political situation in various countries of North Africa may trigger additional hikes in fuel prices and, as a result, additional upward pressure on inflation.

Figure V
Latin America (simple average): inflation by component, January 2007-January 2011
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

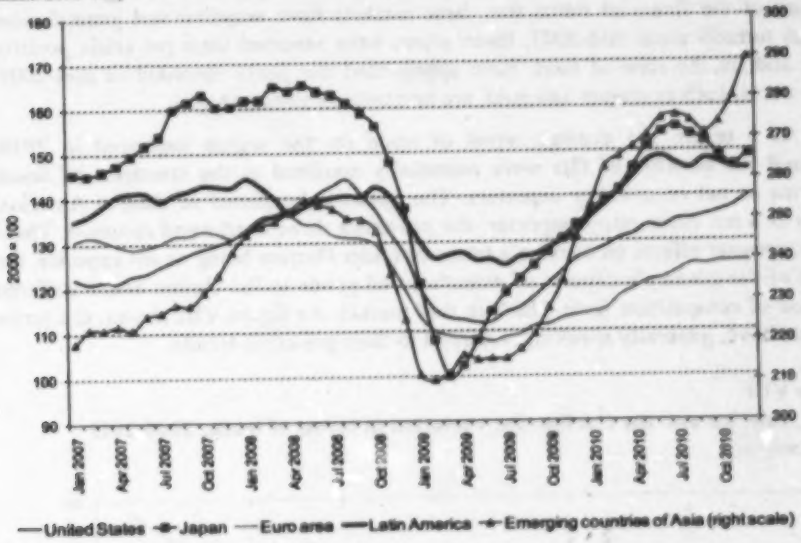
18. Overall, this combination of factors led to a decrease in the poverty rate, which is estimated to have fallen from 33.1% in 2009 to 32.1% in 2010, and a somewhat smaller decline in indigence, from 13.3% in 2009 to 12.9% in 2010, thanks to the behaviour of food prices.

B. External factors

19. The region's export volumes began to rise significantly in late 2009 and, in the second quarter of 2010, exceeded pre-crisis levels (see figure VI). By subregion, the best export performance in volume terms was posted by Mexico and the countries of the Southern Common Market (MERCOSUR), in contrast to the countries of Central America and the countries that export mining products and hydrocarbons (see figure VII).

Figure VI
World exports by region (three-month moving average), 2007-2010

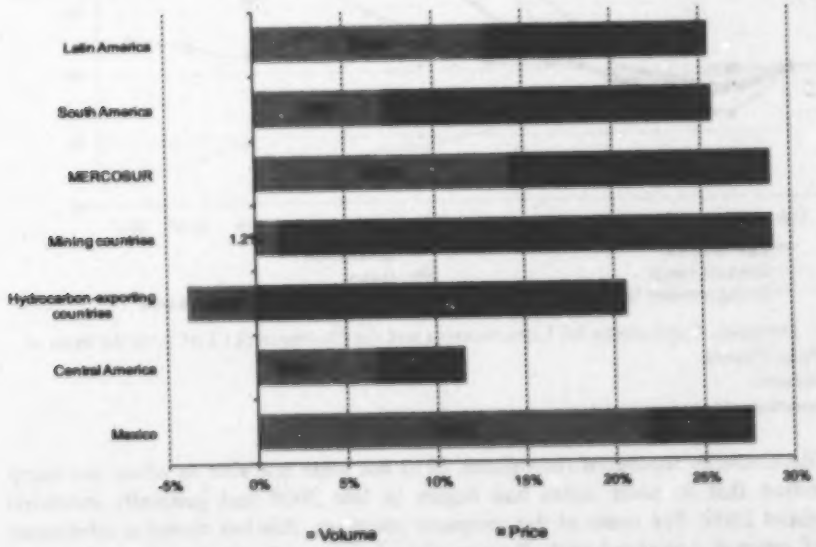
(Index: 2000=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the Netherlands Bureau for Economic Policy Analysis (CPB).

Figure VII
Latin America: export variation by volume and price, 2010

(Percentages)

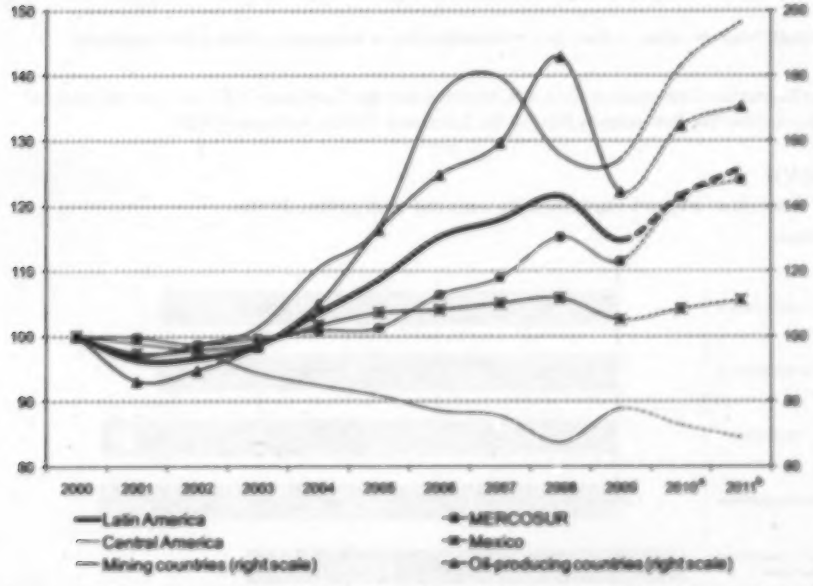


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

20. The rise in export volume was accompanied by an increase in the price of commodities (which account for a significant portion of the export basket, especially for the countries of South America). Although commodity prices are highly volatile because of the financial status that these markets have acquired and general asset market turmoil since mid-2007, these prices have resumed their pre-crisis positive trend and, in the case of food, have approached the peaks recorded in mid-2008; some items, such as copper and gold, are currently at all-time highs.

21. As a result, the average terms of trade for the region improved in 2010, although the benefits of this were essentially confined to the countries of South America as net commodity exporters. The opposite happened in Central America, which is a net commodity importer: the pre-crisis downward trend resumed. There were opposing effects on Mexico's terms of trade. Despite being an oil exporter, the prices of the country's exports of manufactured goods to the United States suffered because of competition from China in that market. As figure VIII shows, the terms of trade have, generally speaking, returned to their pre-crisis trends.

Figure VIII
Latin America and the Caribbean: variation in terms of trade, 2000-2011
(Index 2000=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

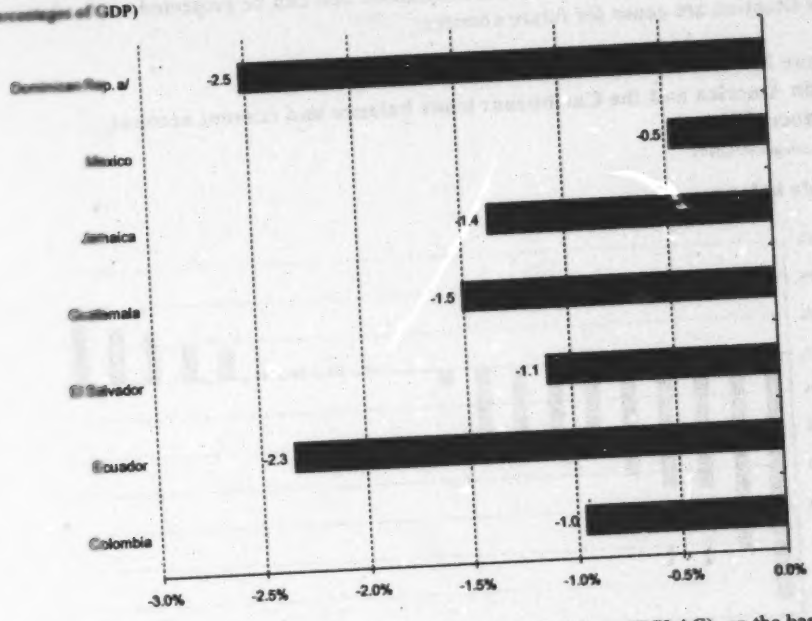
[a] Estimate.

[b] Projection.

22. Remittances recovered throughout 2010 but were not able to offset the sharp contraction that in some cases had begun in late 2008 and generally extended throughout 2009. For some of the recipient countries, this has meant a substantial loss of revenue compared with the pre-crisis levels, with drops ranging between 0.5% and 2.5% of GDP (see figure IX).

Figure IX
Latin America and the Caribbean (selected countries): variation in remittance revenue before and after the crisis[a]

(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Difference between remittance revenue for 2010 and the average for the period 2004-2007.

23. Despite climbing exports, the rapid recovery of the economies of the region — accompanied in most instances by appreciating real exchange rates — has led to an even greater rise in imports, especially in terms of volume. The region's goods trade balance has therefore returned to the downward trend that was interrupted by the crisis.

24. The worsening trade balance is exacerbated when real services (which traditionally run a deficit) are also taken into account, leading to a balance — according to ECLAC estimates — of 0.1% of GDP, the worst level recorded since 2001 (see figure X). The income balance deficit has grown as well, owing above all to larger profit remittances to companies associated with the exploitation of natural resources and which offset the increase in worker remittances. The region would thus have a current account deficit equivalent to 1.1% of GDP; so even if growth resumed in the region, it would not be accompanied by an external surplus as it had been in the years prior to the crisis. Moreover, some of the components of this trend are expected to deepen. As noted below, a larger current account deficit is therefore projected for 2011.

25. The current account deficit does not threaten the growth of Latin America and the Caribbean in the short term because financial resources are flowing to the region from a variety of sources in an amount that will not only finance the current account gap but will even allow the accumulation of international reserves. The region has

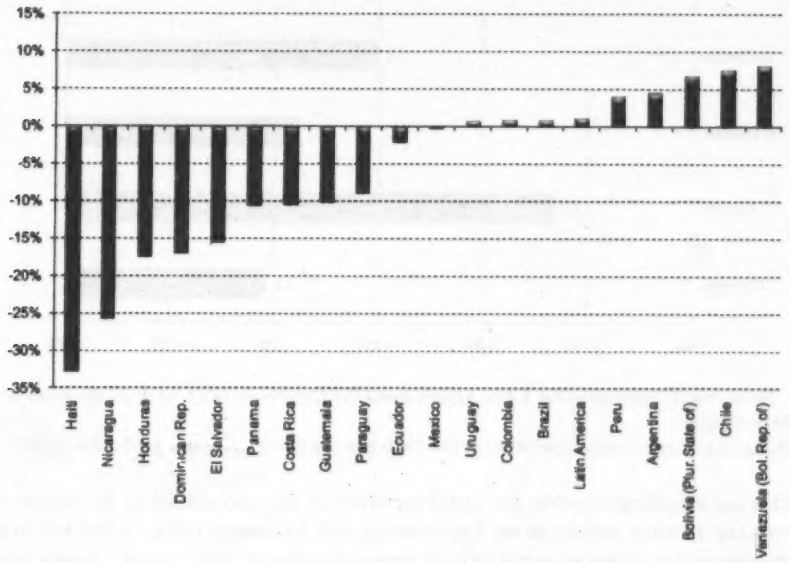
returned to the international markets, and the debt instruments of almost all the countries have been upgraded and their sovereign risk premiums have improved substantially (although they are not yet back at pre-crisis levels). Nevertheless, as will be discussed below, some of the scenarios that can be projected on the basis of this situation are cause for future concern.

Figure X

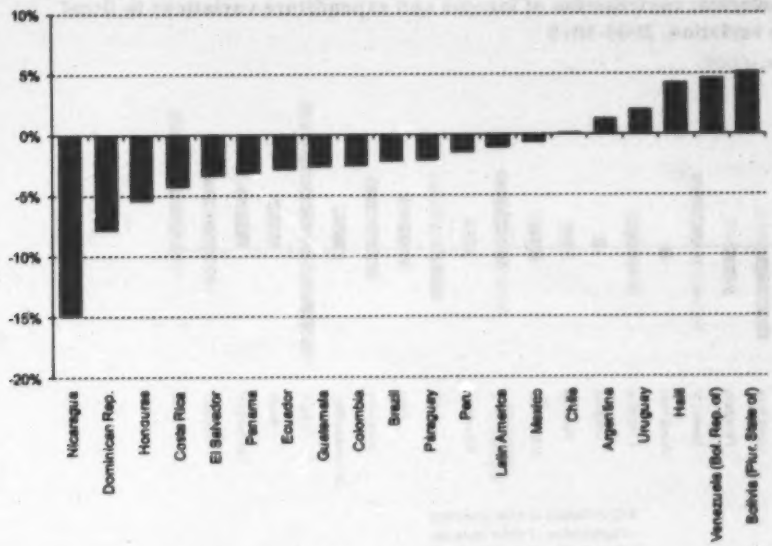
Latin America and the Caribbean: trade balance and current account balance, 2010

(Percentages of GDP)

A. Trade balance



B. Current account balance



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

III. Macroeconomic policy

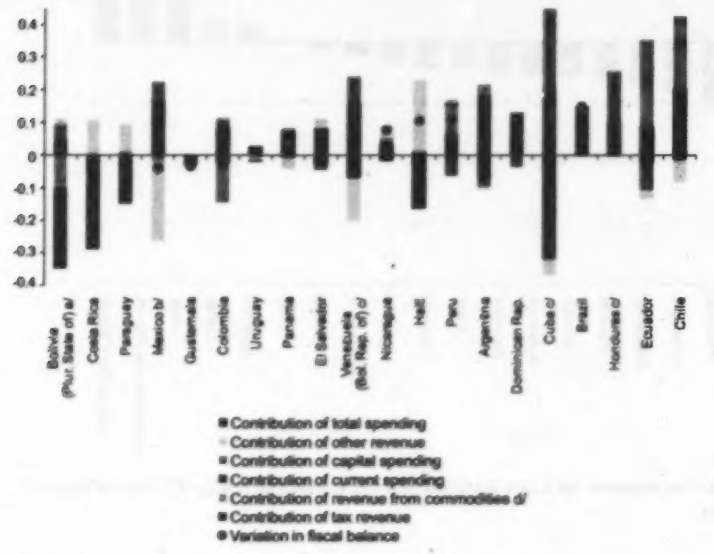
26. After a year like 2009, in which countries deployed massive countercyclical policy efforts to address the impacts of the crisis, the strategy for 2010 was a general pull-back of public policies targeting demand, albeit with marked differences between countries. To a certain extent (especially in the second half of the year), macroeconomic policies began to reflect the growing concern about currency appreciation in the region stemming from the sharp increase in liquidity in the global financial markets.

A. Fiscal policy

27. Revenue behaviour was the main determinant of fiscal performance in Latin America and the Caribbean in 2010. The principal contributing factors were the upturn in activity and (in countries specializing in producing and exporting natural resource-intensive goods) commodity price recovery.[2] In most cases, fiscal stimulus policies remained partially in place in 2010. As a result, public account balances in all of the countries of the region either improved or held relatively steady; the exceptions were Costa Rica and the Plurinational State of Bolivia (see figure XI).

[2] But some countries (such as Colombia and the Plurinational State of Bolivia) lagged behind; the price drop of 2009 was still reflected in lower fiscal revenue from hydrocarbons in 2010.

Figure XI
Latin America: contribution of income and expenditure variations to fiscal balance variation, 2009-2010
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] General government.
[b] Public sector.
[c] Total expenditure does not include net lending.

28. Latin America's central governments ended 2010 with a primary fiscal deficit of 0.6% of GDP, as a simple average, compared with a deficit of 1.1% of GDP in 2009. The overall balance (including public debt service payments) was a deficit that went from 2.9% of GDP to 2.4% of GDP.

29. After the increase in public debt balance in 2009 as a consequence of the crisis, in 2010 most countries of the region reduced their level of public debt in GDP terms, thus leading to a drop in regional indebtedness. Underlying the improvement in the debt-to-GDP ratio in 2010 were the strong recovery of economic activity and a lower fiscal deficit. However, although the average ratio dropped, such an average conceals very divergent realities: for instance, Chile had a debt-to-GDP ratio below 10%; Argentina, Nicaragua and Panama had a ratio above 40%; and some countries of the Caribbean had ratios exceeding 100% of GDP.

30. Estimates taking account of national budgets in the region point to continued fiscal account improvement in 2011, with a primary deficit of 0.2% of GDP and a global deficit of 2% of GDP. All in all, the countries of the region are, thanks to rising fiscal revenues, slowly rebuilding their public accounts after the fiscal deterioration in 2009 triggered by the crisis.

31. Recouping pre-crisis degrees of fiscal space after the ground lost in 2008-2009 will require efforts that will vary in nature and magnitude among the countries of

the region because of their differing macroeconomic positions, fiscal revenue products and price elasticities and the measures put in place. In some cases the effort should centre on increasing fiscal revenues. Others will require a firmer effort to moderate the increase in primary public spending (especially current spending), which in many cases has far outstripped the GDP trend growth rate. In some countries, attention should be paid to the repercussions of quasi-fiscal activities. Countries whose debt position is more fragile could seize the abundant liquidity on the global markets as an opportunity to reduce their vulnerability by means of active debt management (lengthening terms, lowering cost).

B. Monetary and exchange-rate policy

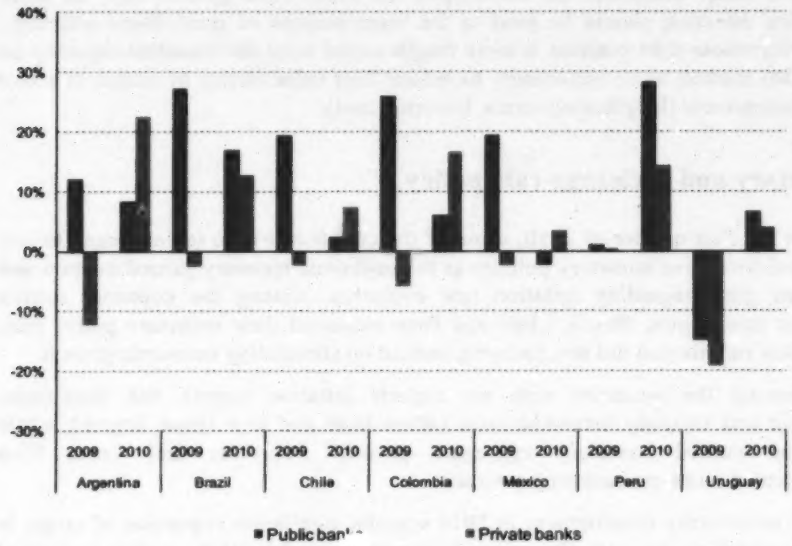
32. In the first quarter of 2010, some of the countries of the region began to roll out more restrictive monetary policies as the economic recovery gained traction and concerns grew regarding inflation rate evolution. Among the countries setting inflation rate targets, Brazil, Chile and Peru increased their monetary policy rate. Colombia and Mexico did not, focusing instead on stimulating economic growth.

33. Among the countries with no explicit inflation targets, the Dominican Republic and Uruguay increased rates (albeit later and to a lesser degree), while Paraguay curbed monetary aggregate growth. Argentina and Costa Rica implemented more expansionary policies.

34. A noteworthy development in 2010 was the significant expansion of credit in various countries. Between November 2009 and November 2010, credit grew in real terms in Colombia (16.1%), Peru (15.1%) and Brazil (14.5%); it also grew in Chile but only by 7%, owing to a progressively more restrictive policy (see figure XII). Private credit propelled this rise in total credit except in Brazil,[3] where public bank credit was the main driver of growth.

[3] Although Peru showed high growth in public bank credit, the weight of the public bank sector there is relatively lower; it was thus the private banks that were behind the credit expansion in that country.

Figure XII
Latin America (selected countries): real credit growth, November 2009-November 2010
(Percentages)



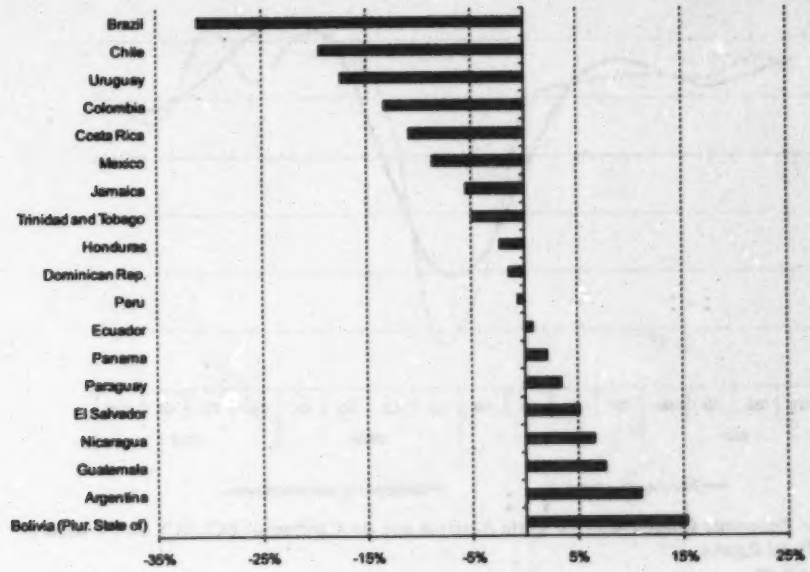
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

35. Looking ahead, some countries may deploy measures to slow the rapid expansion of credit that is putting pressure on currency appreciation in the region — given the excessive international liquidity that spurred capital flows to markets of the region. For example, in early 2011 Peru raised its reserve requirements, among other steps.

36. In 2010 (annual average compared with average for 2009), currency appreciation was highest in Brazil (12%), Colombia (12%), Uruguay (11.2%), Chile (8.8%) and Costa Rica (8.3%). To moderate exchange-rate volatility and appreciation, especially in situations of historically low effective rates of exchange, some countries deployed measures that included reserve accumulation (Argentina, Brazil, Colombia, Costa Rica, Guatemala, Mexico and Peru) and sought to stem capital inflows (by means of taxes and restrictions in Brazil, which increased the financial transaction tax on foreign investment in fixed-income instruments — first to 4% and then, in October, to 6%) and increased outflows (Chile and Peru raised the overall limit on pension fund investments abroad).

37. In real terms, these movements were even more pronounced. As can be seen in figure XIII, real exchange-rate appreciation was fairly widespread and led to real exchange-rate parities below pre-crisis levels. In several countries, real effective exchange rates were therefore substantially below the historical average for the past 20 years. Four countries were more than 20% below their historical averages: Brazil (25.8%), Bolivarian Republic of Venezuela (25.4%), Trinidad and Tobago (24.5%) and Colombia (21.1%).

Figure XIII
Latin America and the Caribbean: variation in real effective exchange rate, December 2008-December 2010
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

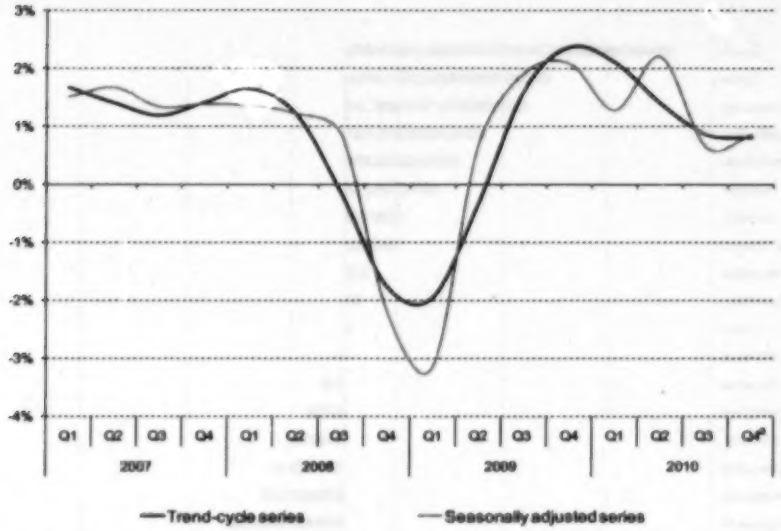
IV. Prospects for 2011 and macroeconomic challenges beyond the short term

38. ECLAC estimates that the region will continue to grow in 2011, although at a slower pace than in 2010. With the pull-back of public policy efforts to spur demand, the region's economic growth is expected to slacken as idle production capacity is exhausted and the global economy slows, with the resulting effect on trade flows. As figure XIV shows, the pace of growth already began to fall off in the third quarter of 2010.

39. The projected growth rate for Latin America and the Caribbean in 2011 is 4.2%, with per capita GDP rising by 3%. The pace of growth in South America is expected to continue to be slightly above the regional average, at 4.5% (see figure XV). Slower growth is projected for Central America (including Mexico), at 3.9%, and the countries of the Caribbean, at 2.2%.

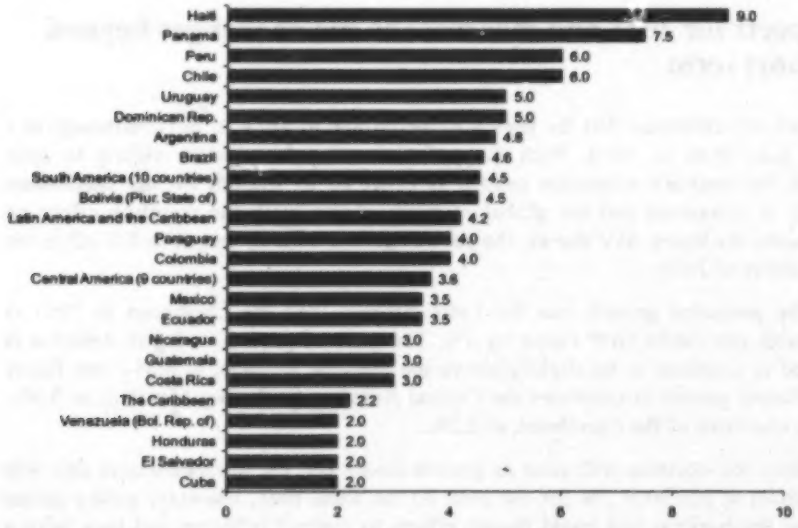
40. Since job creation will slow as growth slacks off, the unemployment rate will creep down to just over 7% for the year. At the same time, monetary policy issues loom on the horizon and could thwart efforts to control inflation and thus have a negative impact on real wages.

Figure XIV
Latin America (seven countries): quarter-on-quarter real GDP variation, 2007-2010
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Estimate.

Figure XV
Latin America and the Caribbean: GDP growth, 2011



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

41. Concerning the evolution of external-account indicators, the region's terms of trade should continue to improve despite volatility in the global financial markets that could affect price movements for many of the region's principal export products.

42. Good prospects for the region's terms of trade could benefit most of the economies of South America, but rising commodity prices could mean lower revenue in real terms for the countries of Central America and the Caribbean (with the exception of Jamaica, Suriname and Trinidad and Tobago). For Mexico — which exports manufactured goods principally to the United States — the impact will be quite limited even though it is an oil exporter, due to price competition in manufactured goods from China. Although average prices will improve in the region, the trade balance is expected to deteriorate further in 2011, with the current account deficit rising to 1.5% of regional GDP.

43. The space for implementation of the public policies that enabled the economies of the region to recover swiftly will be affected not only by the need to rebuild countercyclical response capabilities in certain cases, but also by concerns arising from excess global liquidity that could result from monetary policy in the United States. This will be a key monetary and fiscal policy factor for the countries of the region that are potential receivers of capital inflows over the short term.

44. Because of the need to rebuild pre-crisis fiscal space and the desire to keep an expansionary strategy from increasing pressure on the financial and currency markets, fiscal efforts are expected to pull back from the levels seen over the past few years.

45. The search for high returns and low risk that many of the financial assets of Latin America and the Caribbean can offer could channel more short-term capital flows towards the region. This could be a source of instability that would shape monetary and exchange-rate policy.

46. First, it could lead to exchange-rate imbalances and currency over-appreciation in the countries of the region if the economic authorities elect not to intervene in their exchange markets. Another possibility is that it could lead to a monetary imbalance that, with narrowing idle production capacity margins, could set off inflationary pressures (as is currently occurring in some countries of the region) were central banks to intervene by buying currency to defend nominal and real parity as much as possible. Between the two extreme alternatives for intervening in the foreign exchange markets there exists a range of possibilities combining the two but sterilizing the resulting monetary expansion, at least in part, by raising interest rates to continue to encourage capital inflows, thus rendering less effective the efforts to defend real parity. This is indeed a dilemma with significant implications beyond the short term, as will be discussed below.

47. Greater global liquidity will most likely help to deepen the trend towards real appreciation of most of the currencies of the region already seen in 2010, regardless of efforts by the monetary authorities of the region to control the channels through which resources flow towards their economies. A drop in the real exchange rate would affect the production of tradable goods, that is, both exportable products and those that compete with imports. This, combined with the projected slowdown of the global economy (especially in the developed countries), would impact the external component of the demand for goods. Central America and Mexico, whose trade is

more oriented towards the United States market, would feel the impact the most, although it would likely ripple through all of the economies of the region.

48. This would have a negative impact on external accounts but would not endanger growth, at least in the short run. On the contrary, the region is expected to continue to grow in 2011, albeit at a pace that is closer to potential GDP growth, helped by internal demand as credit becomes more available. In South America, this could be boosted by external demand from the Asian economies (although the recent earthquake in Japan could have a temporary impact on this situation) as they continue to grow at a rapid pace.

49. This is not the first time that the Latin American and Caribbean region has seen a massive inflow of short-term capital towards its asset markets and the resulting appreciation of real exchange rates. As seen in similar situations, capital inflows are expected to support steady growth in domestic demand. The downside could be a gradually worsening trade balance, although currency appreciation could help check inflationary pressures caused by rising commodity prices.

50. This economic scenario could have a positive effect on poverty indicators to the extent that a large proportion of consumption among the poorer strata is in tradable goods whose relative price is expected to fall along with the real exchange rate. Income distribution might even improve, at least in the short run, provided that the increase in relative income for the poorest strata does not come with deteriorating labour market indicators. Even so, these improvements could be cancelled out by higher prices for foodstuffs and transport.

51. Beyond the short term, though, the impact of the trends towards exchange rate appreciation could be very negative. The region has already been the stage for many stories with unhappy endings when growth came with unsustainably low (appreciated) real exchange rates.

52. A scenario like the one that could be starting to take shape in the second half of 2010 (with high global liquidity exerting downward pressure on real exchange rates and upward pressure on commodity prices) could lead to (a) increased production of non-tradable goods to the detriment of tradable goods, with the consequent negative impact on external accounts, and (b) overspecialization in the production and export of primary goods. This could be exacerbated if China, as a source of demand for commodities that also competes on the manufactured products markets, were to appreciate its currency more slowly than the countries of Latin America and the Caribbean.

53. Such specialization would make the economies of the region more vulnerable to external shocks and add to the volatility of domestic macroeconomic aggregates such as investment, thus hobbling the economies' capacity to grow, generate productive employment and reduce inequality. And that would be only the effects on the real sector.

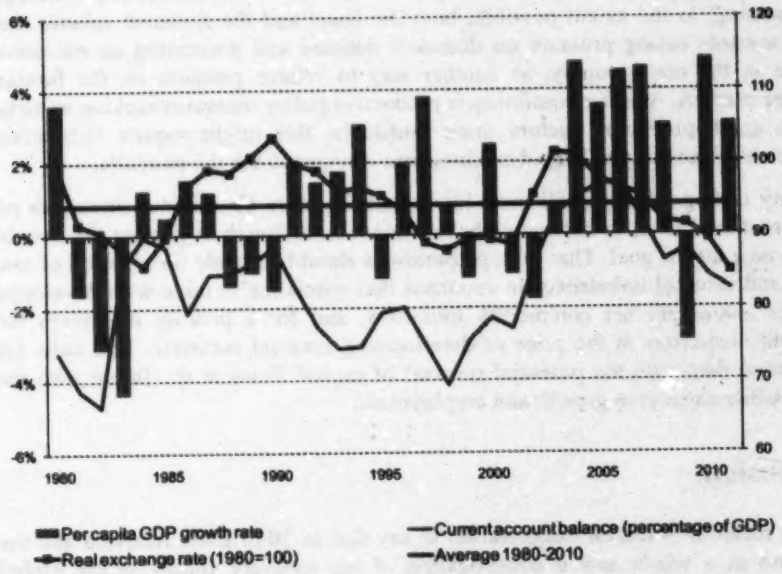
54. But the impacts generated by the financial markets are usually swifter and more devastating. Economic growth accompanied by further external account deterioration could make the economies of the region more dependent on external savings to fund expansion, unlike what happened in the period 2003-2008.

55. During that period, growth came with rising domestic saving rates and an external account surplus. This enabled the economies of the region to deflect the

crisis, because they did not need to turn to the financial markets when these markets had serious problems (to a certain extent, they still do). Quite the opposite: the countries of the region (albeit with differences between them) built up a capacity to act countercyclically that quickly put them back on the road to growth.

56. The region's economic history over the past 40 years is full of examples of how processes involving excessive capital inflows can lead to growth based on domestic demand, but with a gradual deterioration of external accounts (see figure XVI). Such deterioration is due to excess domestic spending in relation to productive capacity and to a relative price shift associated with falling real exchange rates, thus discouraging exports and making imports relatively cheaper.

Figure XVI
Latin America and the Caribbean: per capita GDP growth[a] and current account balance,[b] 1950-2011
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Annual variation rates, in 2000 dollars.
[b] In percentages of GDP.

57. Initially, the balance-of-payments current account deficit can be financed in part with long-term capital inflows associated with foreign direct investment flows, as is happening to a large extent at present, or with the reserves that the countries of the region have built up over the years. However, at some point this will drive external indebtedness up, not only making the economies of the region more vulnerable to terms-of-trade shocks because of their increasing specialization in commodities, but also increasing their vulnerability to financial shocks to the extent that growth would become more and more external finance-intensive. In this

environment, a sudden reversal of capital flows could set off an external financial crisis that would halt growth and give rise to a painful adjustment period, as the Latin American and Caribbean region, unfortunately, knows all too well.

58. So, what can the countries of the region do to defend themselves against this exogenous situation? Several countries have put in place or strengthened mechanisms for regulating the entry of short-term capital in order to ease pressure on the foreign exchange markets. This is a step in the right direction, but restrictions like this might not be enough in the face of such potentially large increases in the supply of foreign exchange.

59. For this reason, the central banks have in many cases elected to make currency purchases to sustain demand and try to prevent or at least slow appreciation. This strategy is not without its problems and limitations, but it could at least ease the transition while reserves are built up to strengthen the external position of the economy.

60. Such measures should be complemented by a countercyclical strategy encompassing, to the extent possible, both the fiscal and the financial spheres and geared towards easing pressure on domestic demand and preventing an excessive increase in the credit supply, as another way to relieve pressure on the foreign exchange markets. Another possibility is productive policy measures seeking to make tradable goods-producing sectors more profitable; this might require redirecting some items of public spending or making some changes to the tax structure.

61. Any lasting solution will most likely call for more coordinated strategies on the international level to narrow global imbalances, although at present this would seem to be a far-off goal. That said, preparations should be made for a period of low growth and external imbalances in countries that specialize in trade with developed countries and/or are net commodity importers, and for a pick-up in growth for commodity exporters at the price of deteriorating external accounts. This calls for measures to deal with the potential reversal of capital flows in the future with the least possible damage to growth and employment.

V. Conclusion

62. To recap, it is not an exaggeration to say that in 2010 Latin America and the Caribbean as a whole saw a consolidation of the recovery following the global financial crisis. While there were differences between countries, the economies of the region generally exhibited levels of activity that topped pre-crisis levels while maintaining a solid external position. This was possible because they had earlier built space for countercyclical policy action and benefited from an external environment that, although highly variable and uncertain, was generally favourable for recovery. Recovery was thus swifter than expected and cushioned the social effects of the crisis.

63. However, the post-crisis situation holds new challenges that the region should prepare for. This task will be harder for those countries that benefited the least from the high commodity price cycle in the period 2003-2008, and which resumed in 2010.

64. First, a significant portion of countercyclical capacities had to be drawn on to deal with the crisis. Although public finances are relatively balanced and public debt

levels are, in general, low, there is little margin for facing any drop in external demand or counteracting the poor external performance that is expected in the light of slow growth in the developed economies. This is even truer for some countries of Central America and the Caribbean with relatively higher levels of public debt and/or very low tax burdens.

65. The need for sustainable public finance is one of the painful lessons to be drawn from the Latin American experience with instability in decades past. The consequences of a lack of moderation in this sphere were reflected in acute inflation followed by severe adjustments that lowered the standard of living, had a concentrating effect on distribution, exacerbated poverty and did not create conditions conducive to growth.

66. During the next few years, the external environment is likely to be turbulent as some developed countries face the challenge of restoring solvency to their financial systems and redirecting their public finances towards realistically sustainable paths. The earthquake in Japan and the political events of West Asia and North Africa will also have an impact on economic performance in the region. Moreover, rebuilding global balances between the developed and emerging economies as needed for post-crisis recovery will pose substantial macroeconomic challenges for the region, in the form of fluctuating export prices, external demand and real currency parities, along with the danger of even more specialized productive patterns that are not necessarily conducive to high economic growth and a more equitable distribution of the benefits.

67. In short, the macroeconomic challenge for the region is to rebuild its capacity to act countercyclically while continuing to create conditions for productive development that is not based solely on commodity exports.

68. Rebuilding the space for countercyclical action as part of a development strategy for dealing with development challenges is a multidimensional public policy exercise that centres on getting back on track to greater public spending that is consistent with social demands, with the expected evolution of the medium- to long-term determinants of public revenues and with debt levels that can be managed without major policy shifts. This calls for a new social accord, a new fiscal pact on how to progressively meet development needs and on the level and mix of the tax burden for sustaining spending programmes.

69. Fiscal policy plays a key role in dealing with the dangers of an external environment characterized by high global liquidity that, while leading to high nominal prices for some of the commodities that the region exports, exerts upward pressure towards real currency appreciation and undermines tradable sector competitiveness. Although the factors behind the trend towards appreciation of the currencies of the region are exogenous, these pressures are magnified by national savings rates that are insufficient in relation to investment and scant financial development.

70. Beyond the tools that the countries of the region use to discourage excessive capital inflows, over the medium to long term it will be necessary to increase national savings (by, among other things, enhancing the medium-term fiscal balance and bringing public debt down to moderate levels that do not put excessive pressure on the local markets) and to promote financial systems that increase the capacity to generate domestic savings to support investment.

71. In conclusion, the economies of the region should invest more if they are to increase their capacity to grow. Despite the progress made in the years before the crisis, the countries of Latin America and the Caribbean are, in general, still far from the investment levels of the 1970s. The challenge is to base the needed step-up in investment on an increase in national savings that will make it possible to better defend currency parities and thus shape a pattern of productive specialization that is more in line with the region's development needs.